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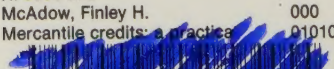

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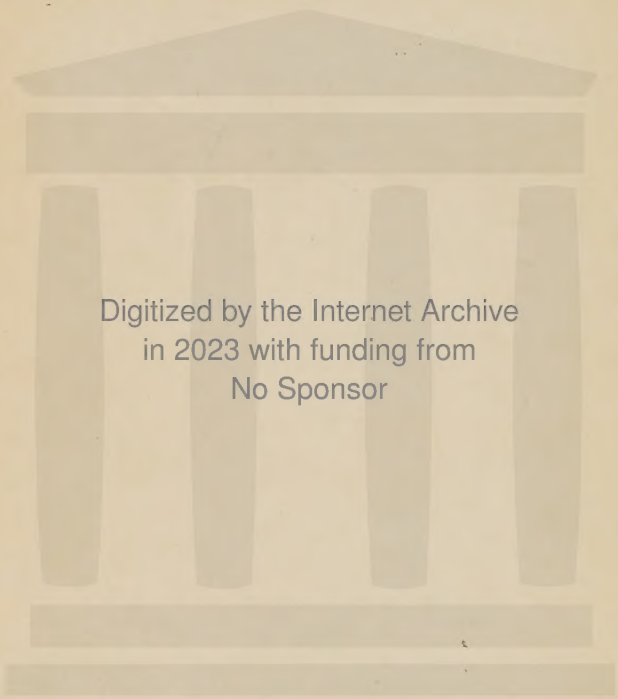

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MERCANTILE CREDITS

A Practical Study of the Credit Man's Work

By

FINLEY H. McADOW

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PREFACE

The purpose of this book is to serve as a means for a more careful study of some of the problems involved in the granting of mercantile credits, and of the principles to be applied in the solution of those problems. In addition to giving this direct assistance, it is hoped that the book will stimulate and encourage a more careful study of the credit question in general.

Now, as in the past, men come into the credit field without previous preparation and learn mostly by experience. Their entrance into this line of work is generally the result of fortuitous circumstances rather than of any purposeful plan. The author himself became a credit man in this haphazard way, passing on credits having been simply added in the course of time to his other duties. Notwithstanding that perhaps the majority of credit men have secured their training in some such way as this, this method of training credit men in the hard school of experience is not only laborious to the men themselves, but unquestionably also expensive to the employing firm, as during the years in which experience is being gained the standard of efficiency in the credit work is bound to be lower than if the men did not rely entirely on experience but supplemented it by study.

What has been written in the following pages may help to make the acquisition of some of this knowledge a less arduous task. The book is the result of many years' experience at the credit desk, supplemented by an extended study of the subject in preparing a course of lectures

given at schools of commerce. It has involved careful consideration of what has been written by many other credit men on various aspects of credit work, and acknowledgment is hereby expressed for the considerable help received in this manner from fellow credit workers.

The book is designed for the use primarily of the younger men coming into credit department work. It aims to impress upon them the importance of a thorough study of their chosen field of labor. It may also possibly prove a helpful text for students pursuing the study of credit in a school of commerce.

In the course of his experience it has been the author's good fortune to have observed a rather extended and varied range of credit work. As a result of this wide observation, he feels that the importance of careful study as a basis for success in credit-granting cannot be overemphasized. In the past, the necessity of a thorough training in this field of business has not been sufficiently recognized; but it is certain that the importance of such training will be felt more keenly as the country's commerce continues to expand and the resulting competition forces all business houses to adopt the best methods and to strive for the highest efficiency in the credit as well as other departments.

FINLEY H. MCADOW

Chicago, Ill.,
September 20, 1922.

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Mercantile Credits

CHAPTER I

CREDIT AND THE CREDIT MAN

Wide Use of Credit

Credit, as the term is generally understood in the commercial world today, may be briefly defined somewhat as follows:

> Credit is parting with the possession of money or chattels in the present, on the promise of the person receiving the property to pay for the goods, or repay the money, at an agreed future time; and on the belief that the person obtaining the property so transferred will be both able and willing to meet the obligation thus created at its maturity.[1]

The function of credit in commerce is to supplement or act as a substitute for capital. Students of economic subjects are agreed that credit is not wealth, but that it is an aid in producing wealth. In this country the actual money in circulation (end of July, 1922) is $4,375,555,000 for over 110,000,000 people, or $39.87 per capita. One can very easily imagine the limitation on our commerce if all transactions were on a cash basis. Credit, therefore, supplements the actual money used in business many fold.

Thus the importance of credit as an agency in the conduct of modern business is almost beyond estimate. For the year 1919 the total volume of American business, including both domestic and foreign trade, and taking in the

[1] Anyone desiring to give more study to the matter of definition, will be interested in a discussion of the subject by W. A. Prendergast in his "Credit and Its Uses," and the quotations he submits from well-known writers on various economic questions.

total of bank clearings, amounted to nearly five hundred billions of dollars, after allowing for overlapping of re-sales and clearings. While it is difficult to obtain accurate or complete data in this matter, it will not be extravagant to say that 95 per cent of this huge total was done by some form of credit and credit instrument. The great bulk of the credit involved, moreover, consisted of commercial credits passed upon and created by credit men in mercantile, banking, and manufacturing lines.

Origin of the Credit Department

The development of the credit man and of the work which he performs is a result of the phenomenal growth of the commerce of our country in the last thirty years or so. By the year 1880 the nation had completed the adjustment of financial and commercial problems and conditions growing out of the Civil War, and had recovered from the business depression of 1873. The effect of an extraordinary extension of railways, an unusual influx of immigrants, and the opening up of the "boundless West," increased the volume of business at a rate unequaled in any other equal period in our history. Up to that time the proprietor or head of a firm had been the dispenser of and the sole authority on credit-granting. The sudden growth or increase in volume experienced by all commercial houses overtook his ability to carry this task, especially when it became impossible for him to meet his customers, or only a very small percentage of them, for a personal interview. His time was now taken up by executive duties pertaining to the growth of the business, to the larger questions of handling the increasing volume, and to determining the policies to be followed in dealing with the rapidly changing conditions. The traveling salesman had come into the field, and he was usually the only

representative of the firm who met the customer face to face.

When the proprietor had to call other men to his aid in different departments of the business, and when what we now call "organization" began, he had to let go of credits as one of the first results of the change. As a rule he gave up that part of his duties with reluctance and misgiving. He had accumulated his knowledge of credit-granting through years of experience, hard knocks, and personal acquaintance with customers. Only the sternest necessity induced him to turn over this important duty to any less experienced man. As the least risky way of meeting the emergency he usually drafted the bookkeeper for the duty, trying to keep in touch with the work, and giving counsel as he had opportunity. The bookkeeper, however, could not handle both accounting and credits, and the work was soon placed in the hands of a special man. In this manner the "credit man" came into the organization. He, like his predecessor, received his training also in the school of experience. The duties he was obliged to assume with so little preparation defined clearly the importance of his position.

Importance of Credits as a Study

The study of mercantile credits received a great impetus at the Congress of Nations held in connection with the World's Fair in Chicago in 1893. A call was issued for a parliament on this subject in connection with the Congress, and the following three questions were proposed for discussion.

1. How can we raise the standard of credit, reduce its dangers and losses, and at the same time extend and increase its usefulness to ourselves and others?

2. How can the quality of information concerning debtors, and the present facilities for obtaining it, be improved?

3. Would it be practicable through co-operation to establish a standard of requirements for a credit basis?

National Association of Credit Men

As a result of the discussions in the Congress a committee was appointed to bring about a national organization of those interested in the subject, and in 1896 the National Association of Credit Men was organized. No discussion of mercantile credits would be complete without a recognition of the great work that has been accomplished by this organization, and its 140 or more affiliated local associations. It has had a strong influence in substituting co-operation for competition in the domain of commerce. The old dogma was "Competition is the life of trade." The new creed is "Co-operation is the more abundant life of commerce." Perhaps its first and greatest reform in business was to establish the interchange of ledger experience. In accomplishing this it was necessary to "break down the middle wall of partition" on prejudice, which up to that time had made any merchant unwilling to give information concerning one of his customers to another house, and particularly when that other house was a competitor.

Legislative Reforms

The enactment of bulk sales laws in all the 48 states, of bad check laws, and of laws to punish the making of false statements for obtaining credit, the establishment and maintenance of interchange bureaus, and of bureaus for investigation and prosecution of frauds, are among the achievements of the association in legislation and other fields of reform. In securing legislative enactments this association has been actuated solely by a spirit of the most self-sacrificing altruism. It has won and held the

respect and confidence of every legislative body from which it has sought aid in securing these reform measures.

The literature which it has issued, giving information on every branch of credit work, has been an unmeasured but powerful force in the education and development of credit men; and it has welded the credit men of the nation into a brotherhood of earnest advocates for the improvement of business conditions and the elevation of the standards of business ethics and ideals. Including the officers, directors, and committee members of the national association, and the corresponding units for each of the local associations, there are approximately 4,000 active credit men, who year in and year out work tirelessly and zealously for the improvement of credit conditions.

The men who joined the organization at Toledo in 1896 as charter members like to be spoken of as the "Old Guard," and those who yet survive take as great pride in this honorable distinction as did the signers of the Declaration of Independence in their day. The growth of membership from the 600 of 1896 to the nearly 35,000 of today attests the great value of the organization.

The need for intensive training is greater than ever before, but the beginner in the credit department today is finding within his reach constantly increasing facilities for training which were not accessible to credit men twenty or thirty years ago.

Qualifications of Credit Man—Knowledge of Business Conditions

To succeed as a credit manager calls for careful and systematic training, which must be largely self-training. The man in this position should have a general and somewhat accurate knowledge not only of business methods, but also of general business conditions.

For opening an account with a new customer—a merchant seeking credit—the credit man will be able to exercise a more accurate judgment if he knows the crop situation and all other conditions which will affect the purchasing and paying power of the people of that territory or vicinity with which the merchant must deal. It may be a manufacturing or mining district. If so, is the general tendency in these industries towards prosperous times? Or is a strike imminent? Or is it likely that the mines may close down?

If it is chiefly a farming community on which the merchant seeking the credit must depend for his patronage, what is the crop condition there, both as to the volume of production and the price at which it must be marketed? Is the territory well populated? What are the land values? Are the farms operated by the owners of the land, or chiefly by renters? All these things will make a difference in the amount the people in that community will be willing to buy and be able to pay for. They are points on which the credit man must be informed if he is to judge accurately whether a prospective customer will have a reasonable chance to sell the merchandise he is proposing to buy and turn it into cash with which to meet his obligations at maturity.

Need of Studying Economics

The successful dispenser of credits in fact should be a careful student of economics as applied to the work of his department. This will involve systematic reading and close application and study; and it will be worth the cost in what it will add to his fund of knowledge. It will require not only a daily glance at the financial pages of the daily newspaper, but also a study of the weekly reviews of business conditions by the mercantile agencies,

and of reports from organizations which seek to forecast the trade outlook. Will it be a buyer's market or a seller's market for the next few months? Will there be lower prices on farm products or a steady market? If the credit man can establish confidential relations with the firm's banker, he can learn whether a tight money market is impending or whether the outlook is for a plentiful supply of loanable funds, for bankers make it a practice to look ahead about six months, and they are usually good credit advisers. All the above conditions have their effect on credits and collections, and they vary for different sections of the country.

The 1920 Readjustment

No period in our commercial history drove home with more telling effect the need of studying business conditions than did the readjustment experiences of 1920. Economic writers had been foretelling with earnestness and emphasis the price reduction that must come—that the initial symptom would be a falling off in retail demand and a consequent decline in prices to the consumer. The price advance had started at the point of production, reaching, in order, the jobber or middleman, the retailer, and the consumer. The trend downward would be in the reverse of this order. It had been announced that the government would hold on to its excess of war supplies and merchandise, lest placing them on the market might make the price decline come too suddenly. The problem was to ease down gradually so that the readjustment might not come as an avalanche. Credit men were warned that the shrinkage in inventories which must follow this unavoidable reduction in prices would put a strain on merchants which many of them might not be able to withstand, and the problem with every credit man

was to put into his daily work the practical application of credit contraction which was the only sure safeguard. The credit dispensers who most quickly foresaw and guarded against the coming change in conditions suffered the least. They not only studied the situation carefully from day to day, but they applied and made sensible use of the results of their study in their daily work.

Benefits of Self-Training

The credit manager should ask for, and will usually find his firm very willing to grant, the opportunity to study all published matter coming to the office which has a bearing on credit subjects. He can thus train himself to exercise keenness of insight and judgment, and to develop highly the power of analysis. In handling the concrete cases that come before him he must learn to reason from cause to effect, and to recognize the fact that certain causes will, with reasonable certainty, always produce the same effects or results. In this phase of his work accumulated experience will be a constant corrective of his judgment.

Good Judgment Necessary

To illustrate, one matter which must always be watched closely is overbuying, for this will almost invariably get the customer into trouble. Yet this tendency is always under the control of the credit man and the remedy is in his hands. Wherever there is overbuying, there is overselling. The problem of the credit man is to discover this danger in time to avoid it.

He will often be called upon to make immediate decisions, with time for only a very limited investigation. In such cases trained reasoning faculties and the ability to make accurate analyses of facts will be of the utmost

importance. His decisions are based usually on a variety of information accumulated in the credit file. The trained mind separates the wheat from the chaff, recognizes the really material facts in the mass, fits them together, giving each its relative value or importance, and then decides whether he has such a bird's-eye view of the character, financial resources, capacity, and surroundings of the applicant for credit, who may reside in a distant state, as will warrant him in extending the credit and enable him to determine how large a credit may be safely given.

A Decision that Was Wrong

In a recent bankruptcy case the following situation developed. A merchant tailor conceived the idea that he could enter the manufacturing field and establish agencies throughout the country to which he would sell cloth from samples. All orders were to be accompanied by cash or shipped C. O. D. He made a financial statement showing resources of about $5,000, and as he would do all business on practically a cash basis, he felt that this was ample capital. He secured numerous lines of credit, because of the evident soundness of his proposition and because of a previous record for promptness. He conducted business on this plan for about two years seemingly with success. Then came the readjustment of prices following the World War. He began gradually to be slow in payments, but continued to use his lines of credit to the limit. None of his twenty or more creditors took alarm at this change in conditions. They were seemingly lulled into a feeling of false security or confidence until accounts began to be from three to four months overdue. Occasional partial payments had been made wherever a creditor had become urgent.

Finally one creditor discovered that this merchant had been absent for about a month. Employees in charge said that he was calling on the agencies of the house throughout the West, but could not say where he could be reached by wire or mail. Then things began to happen rapidly, including bankruptcy proceedings. The schedule showed about $36,000 liabilities, with assets of about $4,000. Two houses had claims for about $5,000 each. The missing merchant could not be located and was supposed to have gone back to Europe, where under the then existing rates of exchange he could live as a retired capitalist. At the obsequies conducted by the creditors it was accepted as self-evident that his integrity was not able to stand against the test of losing money and that the credit men were responsible to the extent that they had oversold the account by not holding him strictly to the terms of settlement. Going beyond safe limits in credit-granting placed before this merchant both opportunity and temptation.

An Important Equipment

Another characteristic which the credit man should develop to the fullest degree is *tact*. Tact and intuition may be closely allied, but usually what is termed intuition is really a prompting of judgment based on some fact in the examination not fully recognized at the time. Such a prompting should always be heeded and traced to its source.

Tact may be described as a combination of common sense, an agreeable manner, and genuine sincerity. It enters into personality. It is vital in the successful handling of the credit department.

The development of tact requires the following traits:

1. *Openness of mind.* In dealing with applicants, the

credit man should exercise a willingness to hear what they may say, to get at their exact condition, and in a degree to put himself in their place, so as to see all sides of a proposition. He should be progressive in his attitude, willing to learn at all times, and to substitute new methods whenever they represent a gain in efficiency.

2. *Care and caution.* He must learn to weigh his words. No tactful man is impetuous. He must acquire the judicial quality of mind.

3. *Development of a good memory, especially as to peculiarities of the customer of the house.* While it is not desirable to require memory to carry facts which should be recorded in the credit file, yet the credit man may frequently be aided by a trained memory in avoiding sensitive spots.

The quality of tact will aid the credit men in developing the faculty of reading human nature. In a personal interview with the customer it will enable him to get the information he desires so adroitly and pleasantly as to avoid causing any embarrassment or arousing any resentment. It will be helpful in dealing with other departments of the business, and especially in securing the hearty co-operation of the salesmen—making them feel that they are a part of the credit force. The invaluable power to read and influence men in this way comes only through training and experience.

Other Requirements

The credit man should be constantly alert to recognize and grasp every item of information that has a bearing on credits. If he reads weather reports or the financial columns of the daily papers, he should be thinking of the effect which every fact may have on credit-granting. He should be at all times and in all places a student of his

enterprise in much the same way and to the same extent as the operator on the board of trade or on the stock exchange scans every bit of newspaper information that may affect the price of his commodity or his investment.

One writer of much experience would require for the successful credit man another qualification which he terms "vision." An ancient writer once said, "When there is no vision, the people perish." Probably this writer on credits does not have precisely such a conception in mind, but he undoubtedly gives the word a far-reaching significance. To the credit man it can mean the ability to look beyond the horizon of his own desk; to add continually to his store of knowledge by reading, and to his stock of experience by exchanging views and ideas with other earnest men in his profession. Or it can mean the faculty of looking into the future and correctly gauging the possible outcome of influences and tendencies which are at work on the credit risk he is considering, and which he alone, perhaps, has recognized. "Vision" may also mean that ideal of attainment which the credit man is desiring for himself, the height and scope of which will largely determine the reality of the success which he hopes to reach—the desire to be not just an ordinary credit man, but the very best possible, never allowing himself to think that he has reached the limit of his development.

Duties of the Credit Man

In many houses the credit man will gradually take on more duties than merely checking the orders and looking after the collections. He will usually have charge of the books of accounting and the keeping of records and statistics. Therefore a good knowledge of accounting will be helpful to him. He will have more or less to do with the financing of the business, at least to the extent of

watching the bank balance, keeping track of payments of notes, and the settlement of purchase accounts.

The credit man will be in a large measure the custodian of the goodwill of the business, inasmuch as this goodwill is represented by the accounts on the ledgers, and he is responsible for the proper handling and the ultimate collection of these accounts. He co-operates with the sales department in keeping these customers loyal and satisfied.

He may be the auditor and statistician of the organization, a student of the details of the business, compiling percentages and keeping comparative records of sales, collections, expenses, and similar details. He may have charge of placing the insurance and keeping it renewed. This will include a decision as to the necessary amount to be carried. These duties may come to him because he is in closest touch with the records of the business, the books of accounting, and the general work of the office. He should not, however, get too busy with details at any time to prevent him from using care in opening a new account, or in watching an old account that may be getting slow. Especially, he must not allow anything to make him careless in the collection of accounts when due.

Primarily the credit man will be judged by the record of losses from bad debts. This item will determine his skill and ability in judging credits. In applying this standard of judgment, the policy of the house in handling sales and fixing terms must be considered. Also, whether the conditions obtaining in his line of trade require a conservative or a liberal rule in securing a proper volume of business will be taken into account. This judgment should be based on the average result of several years' experience rather than of any one year, and it should be

kept in mind that a credit manager, by striving for a low loss ratio, may become ultra-conservative and thus cause loss to his firm in this way.

Reduction of volume means increased ratio of overhead expense. Therefore this standard of measurement should be used with intelligence and discretion. The credit man himself keeps this record of losses, and he should always bear in mind the possibility of loss of trade by ultra-conservatism, or refusal to take any risk on accounts. In seeking to eliminate losses from bad debts he must not lose sight of increasing sales.

Importance of Successful Collecting

If the credit man is handling the collections, he will be judged by the amount of outstanding accounts. The cash receipts should be equal to the sales or relatively so. If the customary terms of the line of business are thirty days, there should not be more than the equivalent of thirty days' sales outstanding on the average. This affects what is called the "turnover" of the business. Where a larger amount of accounts receivable are regularly and continuously outstanding, either credit is being extended too liberally to customers who are chronically slow pay, or the collections are being neglected.

Also the average amount of cash discounts being allowed in proportion to daily receipts will indicate whether the credit man is failing to enforce terms properly and becoming too liberal in allowing unearned discounts. The credit man should keep statistics on these points and pass judgment on himself accordingly. If he is in charge of the office, the amount of office expense becomes a standard of measurement, and this will be a test of his executive ability or capacity to manage.

Some Knowledge of Law and Business Methods Helpful

One practical writer on credits claims that a knowledge of law is indispensable but fails to indicate how much legal knowledge would be necessary. No credit man has time to be a lawyer, but a general knowledge of the rudiments of commercial law will be exceedingly valuable to him. He should realize the importance of keeping in mind the exemption laws of the 48 states; not to try to retain all the details in his memory, but to look them up when checking an important credit in any state. He should also familiarize himself with the basic principles involved in contracts, the Statutes of Limitations, how to draw a continuing guaranty contract, a proxy, a bill of sale, a power of attorney, a proof of claim, and similar legal forms. He can inform himself concerning the rights and liabilities of married women, the bulk sales laws, the Uniform Sales Act, the Negotiable Instruments Law, and the foreign corporation laws of the different states. This rudimentary knowledge of commercial law will frequently keep him from making a mistake that might be expensive, and will help him bear in mind that it is frequently important for a credit man to know when he ought to obtain legal advice on some of these points before he goes too far.

A knowledge of business methods may help the credit man in determining when the customers of the house are doing business with such methods as will give them a fair chance of success, considering the line of business in which they are engaged. Do they know what it costs them to do business? Constructive credit-granting contemplates the ability to advise the customers of the house on such points when it develops that they need assistance.

Member of Firm as Credit Man

One writer on credits has advanced the suggestion that the credit man should always be an employee and not a member of the firm. He gives two reasons for this view: (1) if the credit manager is a member of the firm he will to a greater extent be desirous of increasing sales volume and profits and will unconsciously or consciously allow these objectives to sway his judgment and incline him to be too liberal in judging credits; (2) if he should not be successful in discharging the duties of the credit position, there might be too much difficulty and embarrassment in persuading him to give way to someone else better qualified.

Therefore, this writer argues, the credit manager should be an employee whose position depends entirely upon his successful discharge of its duties and who can be more readily changed or relieved if a change is found necessary.

Whether this view is correct will depend largely on circumstances, on the organization of the firm, and on the personal equation. No arbitrary rule can be applied. It is not difficult to believe that as a rule the member of the firm who is a misfit at the credit desk will be open to conviction, and his self-interest will aid him or prompt him to give way to "the man who can."

Question of Authority

There are those who hold to the view that the decision of the credit man should be final and that no one should be allowed to overrule him—that he should be the supreme authority in his department. At first glance this theory seems to assume infallibility for the credit man, which is a dangerous and untenable assumption. It is more likely, however, to be based on the thought that

since the credit manager is responsible for the success of his department he should have a free hand and be unhampered, because only then will he be willing to be judged by the results he achieves.

It will probably always be better for the credit man not to demand this authority in an arbitrary manner, or as a right. Such an attitude may not be an aid to team work and may prevent that perfect spirit of co-operation which is the ideal element in organization. His attitude should invite advice, suggestion, and co-operation, and show a readiness and willingness to take the responsibility of the final decision.

Let the credit man show that his decisions are based on sound judgment and that he can always defend them with valid reasons, and let the result of his decision vindicate the accuracy of his conclusions. He will then have little difficulty in obtaining recognition of the authority which he thinks should go with his position. In fact, he may be agreeably surprised at the cheerful unanimity with which everybody will yield the responsibility to him.

CHAPTER II

THE CREDIT RISK—THE CUSTOMER

The Credit Equation

Every order which comes to the desk of the credit man represents an equation to be solved, the unknown quantity in which is: "Will he pay?" It is the task of the credit man to be reasonably certain that he has found the correct answer to the equation. He needs to make sure, so far as possible, that he is dealing with all the factors which have a bearing on the equation before him. Overlooking even one minor detail or fact in the information obtained, or failure to obtain all the facts which will influence the final result, may lead to a wrong conclusion.

Capital, Capacity, and Character

It is perhaps not definitely known who first summarized in alliterative form the factors which enter into the credit equation. At all events, William Post, of the Central National Bank, Philadelphia, in a published discussion, grouped these factors under the three headings of Capital, Capacity, and Character. This grouping has been favorably regarded by credit men, perhaps originally because of the alliteration, and later because of the comprehensiveness of the classification, for there is probably no factor which cannot properly be included under one of these three captions.

Considering the three factors in the order of their im-

portance, the following standards of relative value will be reached:

1. *Capital.* To show that the applicant has sufficient resources of his own to finance successfully the volume of business he is attempting to do.
2. *Capacity.* To show that he will know how to conserve his capital and resources with such care that he will continue to discount his purchases or meet his obligations, and keep on a safe basis.
3. *Character.* To indicate that he possesses those qualities of honesty and integrity which will make him always willing and determined to meet his obligations, no matter what unexpected emergencies or conditions may develop.

Dealing with Credit Risk on a Percentage Basis

Accepting this grouping, if the risk under consideration should be dealt with on a percentage basis, the rating of the ideal credit—that is, the merchant who may safely be trusted without any doubt or question—will stand at 100 per cent. Then as a standard of measurement, if it is assumed that the three factors are of equal importance as a basis for credit, the division of this percentage will be as follows:

Let capital, or financial resources, represent	33 1/3%
Let capacity, which covers ability and experience, represent	33 1/3%
Let character, which includes honesty and integrity, represent	33 1/3%
Total	100%

Those who desire to strive for mathematical accuracy in their decisions may then measure the particular credit under consideration according to these standards or percentages. Credit men will, of course, differ materially as to the application of such a percentage plan, and some of them will perhaps reject it altogether.

Importance of Capital

Credit men who place the emphasis strongly on capital as the main basis for credit have a strong argument for their position. It surely ranks first as a credit foundation, for when the dispenser of credit looks at the large assets and small liabilities of the firms which always take cash discounts or who pay promptly at maturity, he is justified in believing that such applicants for credit have capacity and character also, or they could not have achieved the success which these ratings indicate.

It will probably be found by most houses, and in nearly every line of business, that from 70 to 75 per cent of the orders received in any season are accepted on the mercantile agency ratings alone, especially those from regular customers who discount their purchases. These orders give the credit man no anxiety whatever. The houses from which they come have adequate capital and small liabilities, and unless the order is for a much larger amount than usual, or is from a new customer, it is accepted without taking time to revise the credit file. In the case of a new customer a credit file should always be made up.

The remaining 25 or 30 per cent of the orders come automatically into a different class. They are in that other class because the mercantile agency ratings on them indicate that they do not possess adequate capital, are not discounting their purchases, and their credit rating is restricted accordingly. Sometimes this withholding of agency rating may result from lack of information, but that fact is quickly disclosed under the usual investigation. Those applicants for credit who have no agency ratings as to capital and those whose credit rating is questioned, all become equations in which the unknown quantity—"Will he pay?"—must be carefully ascertained.

Capacity—Its Elements

When capital is lacking, dependence must be placed on the other two requisites for a credit basis, viz., capacity and character, the latter of which is treated in the next chapter. All orders from this class of customers come under the head of close decisions. The investigation must be searching and complete. In every case the credit man should probe first of all for information as to possible resources. There may be some capital assets which have not been disclosed by information thus far obtained; while if the credit file on an old customer is being revised, there may have been some change in capital conditions which the credit department should know.

The factor of capacity includes both ability and experience. There are two classes of customers to whom this test should be carefully applied. The first is comprised of those who have previously been in business and therefore have established a record by which they can be gauged. The second class comprises those who are going into business for the first time and whose capacity has not yet been tested.

It has been claimed by credit men of experience that if a firm or individual embarks in business without at least a reasonable amount of capital, this fact is in itself an indication of lack of ability or good business judgment and raises a question at the outset as to capacity. There is some show of reason for this view. Every such firm must make an investment for fixtures and equipment, and must go through a period of building up the necessary volume of trade to give a profit in excess of the cost of doing business. Until that point is reached, the undertaking is in an experimental stage that will furnish the severest test of capacity. Many an enterprise has failed to last through the process of "getting started." It will

require the best judgment of the dispenser of credits to determine in such cases whether the applicant has a reasonable chance to succeed in his undertaking.

As opposed to this claim it may be urged that the majority of successful firms began with limited capital or perhaps none at all, and yet have developed a large and prosperous business. When the records and methods of such firms are investigated, however, it will be found that they were content to begin in a small way, and that they traded strictly within the limits of their small resources until accumulating profits enabled them to expand with safety. This in itself is one of the most satisfactory and convincing tests of ability.

Prudence and Thrift

A credit man for a large western wholesale house related an incident in his own experience which illustrates what a small beginning may mean. He met one day in the store one of their most successful customers, whose rating was then $50,000 to $75,000, and took occasion to congratulate him on the success of his business. The merchant said: "I feel that I owe my success largely to you. Do you remember the first time I called on you? I told you I had $75, and that if you would give me a credit line of $175, I could go into business. You at first objected to granting the credit, but we talked it over and you finally consented."

The credit man recalled the incident and expressed his gratification at having been able to contribute in that way to such a successful business career.

"Well," said the merchant, "there was one thing about it which I did not tell you that day. The $75 I had was borrowed."

The only further comment made by the credit man

was that he had never before realized what self-denial, hard work, and strict attention to business that merchant must have practiced in those days of his beginning and while he was getting on his feet commercially. It was an example of genuine thrift.

Applicants with Previous Business Record

In investigating capacity, when there is a previous record in business, the credit man should seek to learn how long this business was conducted without accumulating any surplus or capital, and, if that period was of some length, what the underlying cause was of the failure to earn anything beyond a living. This is a fair test of ability or the lack of it. Lack of success may have resulted either because the merchant was not a successful, competent buyer, or because he is not possessed of good business judgment. If he has failed in any previous undertaking, what was the cause of the failure? Was it poor management? Why does the experience he has gained in his business career not aid him in making money?

Every credit man will find a certain number of cases in which a merchant has been in business a long time and has reached the age of fifty to sixty years. He has accumulated nothing, and his rating is little or no better than when he began. He has come to the time when he is slowing up in initiative and energy. He himself does not realize this, or does not admit it, but the law of cause and effect is working inexorably in his case. He cannot as a rule hold his own or compete with the aggressiveness and enterprise of younger competitors. One indication of this may be that he is no longer taking cash discounts, and another that his volume of business is slowly and surely diminishing. The wise dispenser of credits will not over-

look this factor in the estimate of capacity. Credit should be restricted accordingly, no matter what sentiment or sympathy may dictate.

Excessive Number of Partners

Further, if the firm under consideration is a copartnership, how many families must live on the earnings? This is sometimes a very important question. Can the business earn enough, all things considered, to carry the burden which will be imposed upon it in this way? Many firms start business with three partners. In such cases it frequently happens that within two years two of them have dropped out because earnings were not sufficient for three. If the retiring partners withdrew their capital contribution to the investment, the remaining member of the firm may find it difficult to continue.

With a firm now in business the investigation should include another possibility: What is the record with houses now selling the risk? Are they now trying to close the accounts with him, that is, trying to "unload"? Such an account, in the language of the mercantile agency, had better be left "in the hands of those already interested."

Firms Without Previous Record

If the applicant is embarking in business for the first time with no previous record, then his capacity or ability is yet to be demonstrated. Such cases are difficult to judge, mainly because there are no facts on which to base a judgment. There are some things which may be learned through inquiry, such as: Where did he grow up? What previous vocation has he followed? What is his education? Has he saved up any money thus far, or shown any indication of being thrifty or economical? How much competition will he have to meet in his under-

taking? Has he shown good judgment in selecting his business location?

Inasmuch as his native capacity and ability are to be considered his chief asset, and, in case he does not succeed, his creditors may have to pay for his business education or his failure to develop the necessary qualities, the credit man must be sure of his ground or be able to give himself satisfactory reasons for his action, if he decides to extend credit in such a case.

By what process of divination, or through what exercise of judgment can an accurate decision be reached in such a case? If a personal interview is possible, the credit man's ability to judge human nature may give him some valuable assistance in interpreting the facts he has been able to learn.

In such an instance it may be well to keep in mind the commonly accepted definition of a merchant, which is, "One who can buy and sell goods successfully."

The credit man can only take the facts he has in hand, carefully examine them in the light of his best unbiased judgment, calculate as nearly as he can the probable working out of cause and effect, and decide whether the applicant will meet the requirements of the above definition. Here may be one of the coming merchant princes. On the other hand, here may be merely an applicant who will develop into an average business man earning a living, and possibly something besides, as a result of his effort. Or here may be a man who lacks the necessary qualifications which constitute ability to such an extent that he has no possible chance of success.

Foreigners as Credit Applicants

A considerable percentage of applicants for credit in many lines will be foreigners who have come to this land

of opportunity and have decided to go into mercantile business. They may have been peasants or laborers in the land of their birth, and have neither capital nor experience for this new undertaking. Whether they have ability is something to be determined only by results. Constructive credit-granting will hold beginners of this class to a cash basis until they have demonstrated their ability to succeed.

They quickly discover, however, that other merchants are obtaining credit and they immediately become ambitious to secure the same privilege. They have not had the training which enables them to realize the danger of assuming obligations which they may not be able to meet, and they often fail because they secure credit too easily. Before they realize it they have overbought, or have bought without proper judgment. A study of failures of this class will often show an astonishing disregard of the laws of judicious credit-granting, reflected in large liabilities and nominal assets.

Severest Test of Credit Man's Skill

In the solving of such an equation the credit man finds the severest test of his skill and judgment, but at the same time his greatest opportunity for acquiring experience. Or the proposition may be stated in another form. The credit applicant in this class has no capital of his own. If he has been in business before, he has failed to accumulate anything. If he is a beginner, his ability is yet to be demonstrated. He is asking the credit man to give him that which is a substitute for capital—credit; and to do this on the belief that he will make good. This is the equivalent to asking for a loan.

The credit man must now decide whether the security is satisfactory.

The Factor of Capacity in 1920-21

During the readjustment period following the World War, comprising the years 1920 and 1921, the factor of ability for the time being was the most important consideration in reaching credit decisions. The great majority of firms showed operating losses in their balance sheets, and a large number showed impairment of capital. Both banks and merchandise creditors were called upon to grant liberal extensions to debtors. If given time, they might pull through. The heavy losses through depreciated inventories made the agency ratings of doubtful value as to capital. Capacity, or the good business judgment and ability which the debtor might possess, became therefore the main consideration.

The houses which qualified under this test and which showed evidence of good business management were almost invariably aided in pulling through this time of stress. The large increase during this period in the number of failures among those who were classed under "lacking ability," indicated that those who did not possess this important asset failed to command the necessary credit assistance for tiding over the emergency.

Another C for the Credit Man

Charles E. Meek, a trained credit man himself, at one time Secretary and later President of the National Association of Credit Men, now an Assistant Vice-President of the American Exchange National Bank, New York, has given this timely suggestion to credit grantors:

> There is no mystery connected with the duties of a credit man. No secret formula need be used in the practice of what has been termed the new profession.
>
> There are, however, well-defined rules which, if not recognized, usually bring disastrous results. A credit man is just a human being. His judgment will err as often as that of the next man.

The three C's are famous words in credit circles: Character, Capacity, Capital. Where these are found wanting, either singly or collectively, the employment of *Courage* in arriving at a decision will always lessen business failures, the causes of which are primarily Dishonesty—Incompetency—Lack of Capital.

Courage, in word and action, should be the guiding star of the credit man.

CHAPTER III

CHARACTER AS A CREDIT ASSET

Judging Character

In dealing with the third factor of the credit equation there are certain things that may be classed as fundamental:

1. That character is synonymous with honesty.
2. That honesty is an essential requisite in an applicant for credit, for no one will extend credit to a man known to be dishonest.
3. That it is difficult to determine, in a credit investigation, whether the analysis of the facts obtained has disclosed actual character or genuine honesty, which is an intangible quality, or whether the element of doubt remains.

The physician in diagnosing symptoms of disease under modern conditions has the assistance of the X-ray machine and laboratory analysis. Even with the use of these auxiliaries furnished by science there are cases where a post-mortem examination is necessary to show what actual disorders existed.

The credit man in diagnosing for character meets similar difficulties and feels the need of X-ray machine and laboratory when he is making this part of his investigation. All too frequently he gets the real facts at the post mortem of a creditors' meeting. For character is the pure gold of honesty separated from the dross. It is

what the man really is in his heart. Too often, however, the examination only goes far enough to reveal his reputation, which is what he is supposed to be by the outside world.

It is not known whether Diogenes was a credit man in ancient Greece, but if he was he recognized the difficulty of this part of the investigation and used a lighted lantern as a substitute for the X-ray machine. According to tradition he carried it in daylight through the streets of Athens, and when called on to explain this eccentricity, he replied, "I am looking for an honest man."

Morgan Episode

In discussing honesty as a credit asset, speakers and writers on the subject have frequently referred to an episode in the investigation of the Pujo Committee of Congress when the late J. P. Morgan was being examined. The attorney, Samuel Untermyer, judging from the questions asked, wished to prove by Mr. Morgan that loans were only made to applicants who possessed money or property resources, and that a money trust existed. Evidently Mr. Morgan was not willing to testify that such were the only requisites, and in reply to one question said, "I have known a man to come into my office, and I have given him a check for a million dollars, when I knew he had not a cent in the world." In further replies Mr. Morgan said that this was not unusual and that the first thing in commercial credit is character.

At a convention of the National Association of Credit Men one of the speakers was a clergyman who had chosen "Character" as his subject. He referred to the three C's advocated by the Association, and expressed his gratification at the recognition given by the credit men to character as a basis for credit. At that point he drew

from his pocket a newspaper clipping and read from it, with approval, a part of the examination of J. P. Morgan before the investigation committee above referred to. As he read the statement of Mr. Morgan concerning the giving of a check for a million dollars to a man whose only asset was character, he paused, and in a tone of longing and regret, exclaimed, "How I wish I had known that before Morgan died!" His manner expressed a conviction on his part that with the death of Mr. Morgan that class of bankers had become extinct. He also mentioned the fact that he himself in times past had endeavored occasionally to establish credit relations with bankers, but he said they always introduced him to a fourth C, which they said stood for "Collateral." The merriment in the convention showed hearty appreciation of the point he had in mind.

What has been said above is not meant to imply any question as to the value of character as an asset. The object, rather, is to call attention to the difficulty in recognizing and identifying genuine character in the applicant for credit, and to prepare the student for the careful and searching analysis that is necessary in reaching the correct conclusion in such an investigation.

A noted writer on credit, dealing with this part of the subject, has expressed it as follows: "Only business men have credit in a commercial sense, and it is not the moral character of a person which gives him credit, but his business reputation." Such a reputation is founded not on the opinion of others, but on the test of years of actual record and performance.

Evidences of Character in Past Record

A philosopher or essayist of the New England school has said in substance: That which is counted for virtue in

many men, is merely the absence of temptation. If this is accepted as true, it will only add to the difficulty of the problem; it is highly important to keep it in mind as a possible factor.

In looking through a credit file for evidences of character, if the applicant for credit has been in business and established a record, the search will involve finding an answer to such questions as these:

1. How does he pay his accounts? Are any of them past due? If so, why? Is there anything to indicate an unwillingness to meet his obligations? The answer to these inquiries will show purpose or intent.

2. Is there in the record any indication of fraud or dishonesty? If so it will be better to decline that order or sell only for cash.

3. Has he failed in any previous undertaking? Was there any question of fraud raised in connection with that failure? If so it is like finding the germ of disease in a diagnosis. He cannot pass the character test.

Applicant Without Previous Record

If the applicant has had no previous business record, the examination must proceed along somewhat different lines. What positive facts are to be found in the examination at hand which will throw any light on the character of the risk? What are his habits? On this point something can be learned from his neighbors, though they as a rule mention only such things as are favorable. They are not apt to say anything savoring of criticism, especially in written form, even when there may be reasons for an adverse report. The mercantile agency reports are apt to manifest some reticence also in giving information on this phase of the question. They may go so far as to say his habits are subject to criticism, and

when they do, the statement carries a significance which should not be ignored. Does he drink or gamble? Neither of these habits go with a good business character. What are his interests, occupations, or amusements, outside of business? Will his associations be helpful to him in his business? On such points it is quite important to feel that we know the man.

Assuming that the applicant has accumulated no capital or resources in his business, but must depend on paying for his purchases out of the proceeds of the sale of the merchandise, he becomes strictly a moral risk; for it is known that honesty of itself cannot pay obligations, no matter how good the intention may be. It then becomes necessary to ask: What will the applicant do if he has a bad season and is unable to dispose of the merchandise purchased as he expected to do? What will he do if he becomes ill for a month or two and is unable to look after his business? What will he do if some unexpected disaster befalls his business, making it impossible to meet his purchase contracts? What will he do if some member of his family must go to a hospital for an expensive operation?

Courses of Action in Times of Embarrassment

If any of these or similar troubles befall him, will he advise his creditors frankly as to his situation, offer security through the indorsement of some friend or relative, or propose to pay up in full if he is given a sufficient extension on his indebtedness? Or, on the other hand, will he go first to his attorney with his difficulties, and on that gentleman's advice have a letter sent out, in the customary form, stating that he finds himself financially embarrassed and unable to meet his obligations, and then either call a meeting of his creditors for a certain date (probably at

the attorney's office) or submit an offer to settle his indebtedness at 30 cents on the dollar, coupled with the suggestion that if the settlement offer is not accepted by all creditors, there will be no alternative except filing a petition in bankruptcy?

Which of the above methods offers the more satisfactory or positive indication of real honesty and sound business character? The question answers itself; but in the experience of credit men, which is the course more frequently followed by merchants?

This is not merely drawing a pessimistic picture. All the possibilities here mentioned are things that befall merchants with some degree of frequency. The credit man in passing on the moral risk will be forced to realize that when such a man is tried out by actually losing money in his business, and is facing the fact that his family may come to want, he is meeting the acid test of character. Will he yield to the temptation to use the money of his creditors in order to save them and himself from the results of his misfortune?

Difficulties in Judging Moral Risk

A western merchant of limited resources very recently furnished an illustration of what may happen in such a case. His only daughter became ill and he was told that the only chance of saving her life was to take her to New York City for an operation by a noted surgeon. He at once followed this advice at a cost of about $1,500. When he returned home he notified his creditors of the circumstances and proposed to settle his indebtedness at 25 cents on the dollar. The creditors investigated, found that the money had been spent, that he had no resources from which to pay in full, and promptly accepted his offer.

This incident may not in any way prove this merchant lacking in character, but it is submitted as showing the possibilities that are inherent when extending credit to the moral risk.

Moral Risk Club

A number of years ago there was organized in Chicago, by a group of credit men representing a certain line of trade, a society which they call the "Moral Risk Club." The membership comprises all the credit men of this one particular kind of business. They hold their meetings at lunch time. They have tabulated all the dealers to whom they are selling and who do not have capital and therefore are extended credit on their character as the only asset, which brings them within the definition of the "moral risk." At each meeting this list is discussed and the condition of such accounts with each member house of the club is shown and carefully scrutinized.

A member of the club stated that they considered the organization a necessity in their line, because the extension of credit to their class of dealers on the character asset alone, without keeping very close watch on such risks, would be dangerous and result in undue losses. They have, therefore, mobilized their forces and maintain the program of constant vigilance "against the common enemy." The search-light of daily investigation is kept constantly directed at these accounts.

The existence of this club does not furnish an argument against the character asset, because the club members are constantly selling risks of that class. It does, however, strongly emphasize the difficulty of recognizing and positively identifying character, and being sure that it is in evidence.

Relative Importance of Character

What then is the value of character as a credit basis? Is it not limited to representing a willingness, a desire always to pay 100 cents on the dollar? But is it not also modified always by the possibility that the possessor of character alone may be tempted under the stress of some business disaster to use his creditors' money? If this is possible, it is a limitation on this factor of the credit equation which should not be lost sight of in passing on risks of this class.

The credit man should keep this thought before him: Honesty, character, as an abstract moral endowment, will not pay an account. The customer will have to get the cash to do that. Where, when, and how can he get it?

The Real Basis of Credit

In a monthly letter issued by the National Association of Credit Men to its members in the year 1921, while the readjustment of conditions resulting from the World War was in progress, the fluctuations of exchange values was discussed and the question was asked: "Why should fiat money not circulate at par?" A portion of the answer to this inquiry, as set forth in that letter, is here quoted:

> This question leads to a consideration of what credit really is, and how the value of a credit instrument fluctuates according to its underlying value. A promise is made to pay a certain sum of money at a specified time, and for the liquidation of an account for commodities bought and delivered. What is the value of this credit? No more, no greater than the commodities underlying it, plus the financial abilities; and when the underlying commodities are disposed of or consumed, then the value of the credit diminishes and may become nil.

Every credit student will probably yield mental assent

to the logic or the above answer, and the real import or it may well be kept in mind when passing upon a credit risk which has no capital as an underlying basis, which has not demonstrated capacity or experience, and therefore seems to depend mainly on character as an asset.

CHAPTER IV

THE CREDIT DEPARTMENT AND THE BUSINESS

Three Principal Departments

In every house or firm well organized for efficiency, and especially where a considerable volume of business is handled, there are three departments, very closely allied in the plan of operation. In the larger firms these departments will be under separate management. In the smaller firms one man may be in charge of two or possibly all three of these divisions. But whatever plan of organization may be in operation, the same principles or policies should govern in effect.

The three departments are the following:

1. The purchasing department, which selects or provides the merchandise to be handled by the house, or, in the case of a manufacturing concern, purchases the material and determines the character of the product to be marketed.
2. The sales department, which disposes of the merchandise or manufactured product, converting it into accounts receivable, and at certain seasons of the year placing possibly the entire capital of the firm in the hands of the customers of the house, represented by the accounts on the ledgers.
3. The credit department, which determines in what hands these accounts are to be placed, takes control of them, and assumes the responsibility of converting these accounts into cash and restoring

them again to the working capital through the bank account.

It devolves on the sales department to see that all merchandise purchased and all products of manufacture are disposed of, so that no loss may result from unsold or unsalable stocks that may remain on hand at the close of the season. It rests with the credit department to make sure that all the accounts thus created are paid at maturity, and that losses from bad debts and failure to collect these outstandings are eliminated, or reduced to the lowest possible minimum. The result will test the working efficiency of the department.

Importance of Departmental Co-operation

It will be seen as a self-evident proposition that the three departments must be co-ordinated in their operation and made to work together smoothly, for the accomplishment of one primary purpose or object, viz., that the firm shall make money, because that is the dominating reason for its being in business.

It is the duty of the executive, the manager, or the successful merchant, as the case may be, to be sure that this perfect co-operation exists and that this underlying objective of the enterprise is attained. It is this power of accomplishment which leads to the generally accepted definition of the word "merchant," referred to in a previous chapter, "The man who can buy and sell goods successfully."

In such a well-balanced organization the purchasing department will consult with the sales department in buying or producing that which is to be sold, for the sales end of the business should be well informed as to what is in demand, and have a well-developed idea of what will be a salable line of goods; and it is reasonable that it

should have some voice in selecting that which it will be required to dispose of in the market.

In a similar degree the credit department should have a determining voice in deciding what accounts shall be taken on in the selling process, for it will be charged with the responsibility of collecting these accounts at maturity. The sales department is not willing to be loaded down with unsalable merchandise, and the credit department should not be expected to assume difficult or perhaps impossible problems in the handling of accounts which from the beginning are probably uncollectible.

The necessity for team work and perfect harmony, as well as co-operation between all departments, needs no argument. It will be an ideal situation if the credit department is considered an auxiliary of the sales department, and, conversely, that every member of the sales force is in working spirit a member of the credit department. For, just as the sales department must move the goods and not allow unsalable stocks to accumulate, so also the credit department must keep the books clear of past-due and bad accounts, and reduce the bad debt loss to a minimum. This is a very important function for both departments. Too much capital tied up in either merchandise or past-due accounts creates an unhealthy congestion in the business.

Maintaining Standard of Credit

The modern credit department is an effort to put credit-granting on a more scientific basis in these days of lessening profits and increasing competition. It is necessary to raise the standard of credit, for it is generally conceded that in the United States credit is held too cheaply. Greater conservatism is being urged as to our annual fire loss. The same reasoning should be ap-

plied to our annual "bad debt" loss. The losses from both these causes are enormous and they place a tax or strain on our commerce, which it should not have to bear.

Co-operation Between Credit and Sales Departments

In the carrying out of the policy of co-operation between the departments as here advocated, difficult problems may sometimes be encountered, growing out of two varying causes: (1) the character of the line of goods being handled or produced, and the conditions under which they must be marketed; (2) the business policies which some houses may at times find it necessary to follow in disposing of their merchandise or products.

In some lines it may be necessary to market the stock before the end of the season because of unavoidable loss if carried over. A change in fashion or style, or some other cause, might make this stock worth one-fourth of its cost, or less, if carried into another year.

Such a situation may bring about a consultation between sales and credit management on this problem. Which is better: to carry the stock and let the inventory show the loss because of depreciation of value, or to force the goods on the market regardless of the credit risk and let the result, if it comes through failure to collect the accounts, be shown through the bad debts charged to profit and loss account?

Such a situation may not often arise, but when the issue must be met the credit men should argue against the latter course because of the demoralizing effect, through lowering the standard of credit, which may be far reaching. Better put the merchandise on the bargain counter and close out in job lots than violate the principles of credit-granting. The sales department wishes to avoid the demoralization of the market on prices. But

if merchants are oversold and failures result, the same effect on market demand and prices may come about through slaughter sales of the same merchandise in the form of bankrupt stocks. It becomes a question of business policy, in which the credit situation should not be overlooked.

Harmonizing Conflicting Conditions

Sometimes the struggle for business against keen competition leads the sales department to urge the acceptance of orders on poor credit ratings in order to get enough volume to meet overhead expense. This makes a hard problem for the credit man, but he should insist that such transactions be treated as special cases if the orders are accepted, and that they be OK'd by the sales department or the executive head, not as wise credit-granting but as a concession to business policy or to reduce ratio of expense. A wise manager or employer will not urge his credit department to abandon rule and formula, the study of cause and effect, or the observance of those laws which are demonstrated by the results of experience. He will rather continue to urge a striving for that exactness in the credit work which makes it conform with the requirements of scientific methods. It is not always an easy task to harmonize these conflicting conditions but it is a consummation devoutly to be wished for.

An Illustration of Stock Sacrificing

In the year 1920 a jobbing house in a certain line, having a capital of about $250,000, found at the close of the spring season that its merchandise on hand was between $400,000 and $500,000. The fall in prices which accompanied the readjustment of war values was beginning to get under way, and no one could accurately judge

the level to which the decline might reach. A consultation was held and the decision made that the stock on hand must be closed out immediately to escape further depreciation, and that program was vigorously carried out. It was also decided that no undue risk should be taken in granting cradits, but that reduction in price regardless of cost should be the inducement for moving the goods quickly. The future of credits was at that time decidedly unfavorable.

As a result of this policy this house closed the year with a comparatively low inventory, with all banking and merchandise indebtedness paid in full, and a large cash balance in the bank. In this process the inventory necessarily showed a heavy loss, for orders had been shipped and goods forced upon the house on which deliveries had not been expected at the time specifications were placed because of the great shortage in the particular line of merchandise that was supposed to exist at the time the purchases were arranged for. It took courage to sacrifice the stock without abandoning the rules governing wise credit-granting, but as a matter of good merchandising judgment it proved to be a wise policy. This house was placed in position to buy for cash new goods at the reduced prices to meet its requirements for the next season.

CHAPTER V

THE CREDIT FILE—REPORTS OF SALESMEN AND COMMERCIAL AGENCIES

Thorough Investigation Essential

In a previous chapter the information desired concerning the applicant for credit was set forth with sufficient detail to indicate the salient facts that have a bearing in his case. The methods and processes by which this information shall be obtained, and the sources which should be used in procuring all the facts that are available, must be now carefully considered.

From the beginning the importance of this investigation has been recognized, and it has been tersely expressed in a dictum which has appealed forcefully to all dispensers of credit: "The strength of the credit man is knowledge." This means that too much information can never be secured. There is always the possibility that some dominating or important fact, vital to a correct decision, may not be discovered. Therefore the investigation should be searching and thorough.

Salesmen's Reports

The salesman's report logically comes first as a source of credit information, because it should accompany all first orders from new customers. The importance of this report is apparent from the fact that a majority of houses furnish salesmen with a blank form to be filled out and sent in with such orders. The salesman is the only one

connected with the firm that may ever have the opportunity to meet the customer personally. Therefore, he should become eyes for the credit department and make his report with that fact in mind.

The credit department must keep in mind that the main purpose of the salesman is to sell merchandise. The salesman is usually a firm believer in that doctrine, and his co-operation must be secured in the matter of sending in the credit reports. In securing his assent it is well to have him realize that usually he is required to make only one report on a customer, and that is when the report counts for the most, viz., with the first order. After that the information he is asked to furnish will be called for only in an incidental way, or when the customer may begin to be slow pay, making a file revision necessary.

Further, if the salesman is on a commission basis, in whole or in part (and the majority of them are), anything he can do to aid in a quick and favorable decision on the order in hand adds to the volume of his earnings. Because the salesman is busy on the selling proposition it is a good policy to make his work on credit-reporting as convenient and easy as possible. Some houses use forms requiring quite an amount of detail, which the salesman could answer only after making an investigation through many different sources. This may take too much time or embarrass him with his customer to the point of discouragement.

Simple Form Preferable

The form, therefore, should call for such facts as usually can be learned only through the salesman, and such as the salesman can obtain readily by observation and through casual conversation while taking the order, or through incidental inquiries in other directions after he

is through selling the customer. A reasonable form of report would include these items:

1. Name of firm.
   Town and state.
2. How long in business.
3. Kind of business.
4. Estimated value of stock.
5. Amount of capital.
6. Careful buyer.
7. Location good.
8. Competition.
9. Is stock well kept?
10. Banks with.
11. Buys from.
12. General reputation.

These questions, when answered with reasonable accuracy, will frequently give enough facts to enable the credit man to decide on the order, if it is not too large, especially after getting reports from the bank and from the other houses named who have been selling this merchant. It is important to have the salesman get the name of the customer's bank, as otherwise that information may not be obtained for a considerable period. It will be apparent also that the above questions cover some facts that would not be readily obtainable through other sources.

If the amount of capital invested and the stock on hand are relatively the same, it will suggest to the credit department that there may be a lack of working capital and that it is necessary to know more about the case before deciding.

Reviewing Customers' List with Salesmen

Most houses have salesmen go over their route book or customers' list with the credit manager at least twice a year. Usually this is before the salesmen start out on

the spring or fall trips. This plan offers many advantages. It gives opportunity both to get and give information as each account is discussed, and to make the salesman feel that the credit department can aid him in getting business. This may secure a more willing cooperation from him.

On one occasion a salesman for a certain house in reporting from a town in his territory, said: "Our dealer Williams was out in Washington. I did not see him."

This merchant at that time had not discounted and was beginning to be slow on his account for the previous season. In going over the list with the salesman for the fall trip, the credit man, having a memorandum of the last report, said, "Williams was out in Washington when you made this town. What was he doing? Hunting, fishing, or on a vacation?"

The salesman replied, "No, he owns an apple orchard out there, and he went out to arrange for shipping the crop to market. He will have ten or twelve carloads to sell."

A little figuring showed that at prevailing prices the crop ought to net him $8,000 to $10,000. This was considerably more than the merchant's capital rating and made his prospects seem quite favorable. There was nothing in any reports contained in the credit file to show that he owned an apple orchard and the salesman had not previously thought of mentioning that item.

In the same interview with the salesman, when another town was reached, the credit man said: "This merchant is behind on his payments to such an extent that you had better not try to sell him on this trip; let him catch up first."

The salesman replied: "There is no reason to be afraid of him. I learned on my last visit there that he

is one of the heirs to quite an estate. The division is about to be made, and he will receive his share in cash." The amount named was quite a sum.

There was nothing in the file information to indicate this inheritance, and here again the salesman had not thought of it as an item worth mentioning. He considered it sufficient that he knew of it, but the credit man at once got a memorandum of it into his credit file.

Salesmen in many cases have advance information on many circumstances affecting customers favorably or unfavorably, and frequent conferences with the credit department bring such items to the surface. At the same time the salesman gets a different view as to the importance of these items in aiding to correct credit decisions and he sees a good reason for co-operation with the credit department on such details. Every such consultation or interview should result in establishing closer and more harmonious, as well as helpful, relations between the credit and sales departments.

Commercial Agency Ratings

It is safe to say that in passing on credits at the present time, the credit department turns either involuntarily or unconsciously first of all to the rating books or to the special reports of the two leading agencies, Dun and Bradstreet. Each of these agencies has been rendering these two services to the commercial world for approximately eighty years, and they have come to be regarded as the dictionaries or encyclopedias of credit. It is probably conservative to estimate that in most lines of business 75 per cent of the credits are passed on the capital and credit-ratings assigned by these agencies, taken in connection with the special reports which they furnish. These ratings are based on the capital resources and man-

ner of payment of the firms reported on, and consideration of this fact seems to lead inevitably to the conclusion that capital is considered to be the most important basis for credit.

Character of Service Rendered by Commercial Agencies

It is not likely that these two leading agencies will have any competition in their field of activity in the near future. They are now each reporting on over two million firms in business. In the past thirty years all other agencies endeavoring to furnish a similar service have practically abandoned their undertaking and retired from the field. It is a question whether any new agency could begin now, and in a short time, or at once, be able to perfect such an organization as would be necessary to render such service as these older agencies are supplying. They have expanded their business gradually through a long term of years, and have met the requirements of a vast increase in the volume of our national commerce in an adequate manner and in a progressive spirit. It would require an enormous capital and the establishment of a great working force or organization to enter the field prepared to furnish immediately the same service, on about two million names, that the older agencies have evolved through long years of growth and experience.

One writer on credit, in considering the question, makes this comment:

> The fact of the failure of other attempts to successfully develop mercantile agencies has given to the Dun and Bradstreet companies a reputation for solidarity and superiority that accounts to a great extent for the fame and prestige they have enjoyed for so many years.[1]

---

[1] W. A. Prendergast, "Credit and Its Uses."

Extent of Service

When we consider the scope and magnitude of the task of reporting on the credit standing of more than two million firms in our 48 different states and our dependencies, as well as in Canada, and the further fact that these reports and ratings are nearly always relatively correct, we can better appreciate what is involved in the management of such great enterprises with their army of employees, traveling representatives, and local reporters. We get also an idea of the phenomenal growth of business in our nation when we consider that the number of firms being reported on has doubled in the last twenty years.

These agencies have borne their part well in our commercial expansion. When we were a new and sparsely settled country there was a strong demand for credit. Merchants and manufacturers were glad to extend credit to the pioneers who were opening up and developing this new country, for it was to be their future market. The agencies expanded their organization, followed these pioneers, and furnished to the merchants and manufacturers the information on which credit could be based. They were of invaluable assistance in promoting our commercial progress.

They have not been content with covering all sections of our own country, but in order to aid in our foreign trade they have covered the world, either through their own branches or by establishing connections with similar organizations in foreign countries.

They have rendered another valuable service by publishing, voluntarily and gratuitously, weekly reviews of trade and financial conditions, which have been and are valuable as market information. These publications might be considered good advertising for the agencies, but never-

theless they have been a very much appreciated aid to business.

The use made by the sales department of the rating books in preparing mailing lists of merchants for soliciting business is alone worth the subscription price of the agency service.

The importance of these agencies in credit-granting may be more clearly realized perhaps should credit men endeavor to picture the situation that would exist if this service were suddenly discontinued. What could be found as a substitute?

Lack of Promptness in Reporting

Notwithstanding the recognition of the benefits of agency service, credit men find some things in it to criticize. Perhaps the most unsatisfactory feature is the lack of promptness. This is a handicap on new accounts and first orders, especially with firms just starting in business, and in the case of orders requiring prompt shipments. It may frequently happen that such orders are acted upon and the goods shipped quite a while before the agency reports come in, the decision being made on information received from other sources.

The agencies reply to this criticism by saying that it takes time to investigate and furnish such a report as will insure the greater accuracy which credit men are asking for. Some reports can be made up quickly. Others require much investigation before all the facts can be obtained which are necessary to a good reliable report. This is true; but the fact remains that such a delayed report can only be useful or available on future orders. Therefore, the prompt, up-to-date information obtained from other sources is becoming of increasing importance.

Securing Signed Financial Statements

There is also complaint that special reports do not seem to give sufficient detail and do not show sufficient evidence of careful, searching investigation. The agencies understand this criticism to refer mainly to their failure to obtain property statements in so many of the cases investigated, and they offer in defense the unwillingness on the part of merchants to comply with a request which they consider an unjustified effort to learn details of their business which they regard as confidential and do not wish to make public. They will not submit to this, and usually give as a reason that they can get all the credit they want without making a statement or having a rating.

There is some truth in this defense. Credit men will have to admit that they are in part responsible for this situation, and that the agencies should not be criticized too strongly on this point. From such merchants statements should be required by credit men. It is probably true that most merchants would give a statement more readily to a house from which they are asking credit, if properly approached, than they would to an agency which they think is making money out of the proposition.

In 1902 a referendum was taken by the Mercantile Agency Service Committee of the National Association of Credit Men, which indicated that 37½ per cent of the special reports furnished by the agencies contained property statements. This percentage has probably greatly increased with passing years, and it indicates that the commercial agencies are gaining ground in their effort to obtain statements. It also may indicate that the agencies are still obtaining a larger percentage of statements than is being furnished to houses direct.

Revision of Special Reports

Perhaps the most frequent complaint is the failure of the agencies to keep special reports revised and up to date. They claim that a revision every six months should be satisfactory for credit requirements, but they frequently come short of maintaining this standard of service. If a firm is not frequently investigated it is very easy to fall behind on the revision. The more probable cause, however, is that with the increasing list of names to be reported on, the organization of the agencies cannot keep up with their work. Hence the large number of reports being furnished with the rubber stamp addition, "Will get later."

Co-operation with Commercial Agencies

Credit men will find it a good plan to keep in close touch with the local managers of the agencies either by personal interview or by correspondence. Such intimate contact will have a tendency to improve the service. The subscriber learns what the necessary limitations are, and the agency manager learns what shortcomings should be remedied. The agencies will welcome this sort of co-operation, and they will be glad to have returned to them, with explanations, any special reports which are not up to standard, especially those that are out of date or carry any inaccuracies. Such co-operation helps them to improve the service and to remedy cases of oversight. Sometimes a branch manager will revise a report by rewriting it, changing the language but giving no new information. This is perhaps rare, but it has happened; and when it does, the agency would like to know of it.

One of the chief sources of revenue for the agencies is selling special reports. They know that the better the reports, the larger the demand. As an instance of co-

operation with the agencies, the following may be related: One credit man had a judgment against a merchant in a western town but had been told by the attorney who secured the judgment that the debtor was execution proof. One day in looking through the rating book for another name, he discovered that this merchant against whom he had the uncollectible judgment had a rating of $2,000 to $3,000 second grade of credit. This was about three years after the judgment had been secured. He at once requested that the attorney tell him why the judgment could not be collected on such a rating. The attorney came back with a list of four or five judgments against this merchant on all of which an execution had been returned unsatisfied, "No property found." It was then taken up with the agency, with the result that when the next book was issued the rating had disappeared. The agency regretted the mistake, but was glad to know about it. Such cases, it should be said, are rare.

Improvement of Service

As the commercial agency stands today, the most valuable information furnished is no doubt the rating books, including pocket editions, the special reports, and travelers' letters of introduction. In the special reports the best features are age and antecedents, property statements and confirmation of them when given, and the trade experience, when any is furnished.

The general impression is that under the fees charged by the agencies for their service, the quality and standard of the service could be greatly improved and still leave them a very good profit. If this impression is wrong and the agencies are furnishing, for the present cost, all that in reason can be expected, then it is probably true that their subscribers would cheerfully pay a reasonable

increase in cost for a service that would remedy the defects mentioned above and give other desirable improvements. Greater efficiency in agency service would be a boon to commerce, and the saving by such service of one moderately sized loss from a bad debt would pay the cost of a greatly improved service.

CHAPTER VI

OTHER SOURCES OF CREDIT INFORMATION

Value of Attorneys' Reports

There will be differences of opinion concerning the value of attorneys' reports. They have had a long career of usefulness, however, and are being used successfully by a great number of houses. The criticism of this class of information does not seem to be any more serious or important than that recorded against other media in use of getting credit information.

The outstanding fact in favor of these reports is that they are up to date. If anything had occurred recently affecting the financial standing of the merchant inquired on, an attorney would be very apt to know of it.

The best reports of this kind seem to be those made on the forms furnished by the publishers of attorneys' lists. These blanks contain the fewest number of questions necessary to give a line on the merchant's present condition, and the attorney can answer them quickly. This tends to secure his co-operation and a prompt reply. Sometimes he ignores the questions and answers briefly, "Good for the amount named." When the reply comes in this form it is prima facie evidence that the attorney is sure in his own mind that the risk is good. Otherwise he would answer the detailed questions and let the credit man decide.

Attorneys seem to be willing to carry out their contracts to furnish such reports, and the credit men using

this form of service usually continue to do so year after year without complaint. It is advertising for the attorneys which does not cost them much. Every year they secure a certain volume of draft collections from houses to which they have been making reports, and when such drafts come into their hands they receive the full commission instead of giving up one-third of it to a forwarding attorney. When an attorney in any town has held such a reporting contract for three or four years he has no doubt accumulated in his office a pretty definite record of the financial standing of every firm in his town, and the labor of filling out the reports as they come in is reduced to a minimum. Practically all publishers of these lists give bond for the responsibility of the attorneys on their list, so that as a line of service it is dependable and secure.

These attorneys also in a short time become informed as to the scope and kind of information a credit man likes to have in passing a credit and they shape their reports accordingly.

Tardy Replies

There is occasionally complaint that attorneys do not answer promptly. That is a serious objection when it occurs, but it is comparatively rare and does not seem to be such a drawback to this form of service as to lessen its popularity or desirability. It may happen that an attorney will make a campaign for a political office, which temporarily causes neglect of part of his business; or he may be away for a few days attending court in another city. He usually cleans up on the accumulated reports as soon as he gets back to his office. When he has a partner or a reliable assistant in his office the reports receive prompt attention in any case.

Considering the fact that an attorney, especially in a small town, may sometimes be a very busy man, this form of service averages well. An attorney on one of the lists had received from one of the subscribers an account for collection. After a reasonable time the credit man wrote for a report on the status of the claim. Not receiving a reply, he wrote again, with more emphasis. The attorney then filed the following demurrer:

> This account will be paid by November 1st. There is nothing wrong with the account. A private law practice, and being attorney for our city, also secretary of a Rubber Corporation, and attorney for other corporations, as well as operating a general store, besides the last sickness and death of my father a few days ago, has caused this to be overlooked.

In view of the number of "irons in the fire" the attorney had, the credit man accepted his alibi with contentment and rested on his oars.

Bank Reports

A report received from a bank is a valuable source of information. It is also always up to date, and if the merchant inquired on is a customer of the bank, more real and reliable information may come from this source than from any other.

There used to be a very general and widespread prejudice against bank reports. It still exists in some quarters, but as a rule it is now not very prevalant. This prejudice was based on a belief that the merchant being inquired about generally owed the bank from which the inquiry was made, and that the bank would make a roseate report regardless of actual conditions, in order to induce the jobber or manufacturer making the inquiry to fill the order. Out of the proceeds of the sale of such merchandise the bank would secure payments of the loan,

leaving its customer, the merchant, to be put through bankruptcy perhaps by the creditor who had extended the credit on the bank's recommendation.

Experience probably teaches that the above picture is painted somewhat from imagination. Most banks today have their credit man or credit department. Most of them buy commercial paper and conduct a very searching examination as to credit on this class of loans. They know and appreciate the exchange of credit information. They take a businesslike view of these matters. If a bank were receiving a great many inquiries concerning the credit standing of one of their customers to whom they had given a line of credit, or if they were receiving sight drafts for collection frequently on such a customer, which were returned unpaid, it would, as a rule, put the bank on notice and lead it to revise its credit file—possibly to call on the merchant for an explanation.

Discretion in Using Bank Service

Banks get a great many inquiries on merchants who do not keep an account with them. They have then no immediately available information, but must take time to answer the inquiry and say so. There has been some criticism of banks that ask 25 cents in advance for a report. Some allowance should be made for this attitude on the part of the small town bank, as it is about the only organization furnishing such information without any expectation of getting something out of it in the future. There is little chance for reciprocity. This charge policy was possibly adopted because of the great number of random inquiries the banks were called on to answer. To most houses an up-to-date bank report costing 25 cents is better or possibly worth more than an agency report which may be six months or a year old.

An important point to consider in making a bank inquiry is that it shall be directed to the bank where the merchant keeps his account. This fact can be learned in two ways: (1) from the salesman's report; and (2) by having the bookkeeper note the name of the bank on the ledger when the first remittance comes in. Unless the name of the customer's bank is secured in this way, the bank inquiry is barred in towns having more than one or two banks, and especially in towns like Grand Rapids, Des Moines, or Kansas City.

Every credit man should be systematic about this and not annoy banks with inquiries on merchants whose standing the bank has no occasion to know.

How One Bank Helped

As an illustration of the conscientious way in which most banks will give credit information, the following incident is worth considering. A western house received a first order from a merchant in a cotton state during the year 1917, amounting to about $600. The house followed its rule of making up a credit file for a new customer. This merchant had an excellent rating, and as the reports came in they were so favorable that the house decided to ship the order, although the inquiry sent to the local bank had not been answered. Just before the shipment had gone to the depot the bank report came, advising in positive terms against extending the credit.

This was so unexpected in view of the other information that the credit man, who held up the shipment, at once wrote the bank, explaining the circumstances and asking if they were willing to say why their report was so different from the other reports obtained. The bank answered promptly and frankly, saying that the mer-

chant in question had always deserved his good rating and that they had previously always recommended him for credit without reserve. Just before the armistice was signed, however, he had been tempted to speculate in cotton, had bought it when it was near the peak price, and had bought so heavily that the peace slump had brought him to the verge of bankruptcy. His friends had undertaken to carry him for a time, but they knew that unless the price of cotton advanced again to about 33 cents per pound it would probably be impossible to save his business from liquidation. Under such circumstances this bank felt that the merchant should not seek credit outside the firms already interested, which understood the situation.

This bank was one of the creditors and might have withheld any answer to the inquiry. The course it pursued was certainly most fair and broad-minded.

Form of Inquiry

Bankers in commenting on their attitude on the interchange of credit information and reports, frequently urge credit men not to use, in making inquiries, the ordinary form of inquiry blank, but to write a letter, under signature, stating the size of credit being considered and giving the facts or points on which information is desired. They will respond more readily and freely on inquiries coming in that form, as they frequently have confidential information on their customer which they do not care to give on a form inquiry. Bankers also take into consideration that in making fair and legitimate reports on merchants of their town they are aiding their own customers to strengthen their credit standing and are thus promoting the business success of their community.

Interchange of Credit Information

Since the organization of the National Association of Credit Men in 1896, the interchange of credit information has constantly increased in value and importance, and it has won the popular approval of all lines of trade. There are now many organizations having for their object the encouragement of this method of securing ledger information on credit applicants. They all represent an effort to make the collection of such figures as complete as possible, and with the least amount of detail and unnecessary labor in the process. The credit man finds available in this department of his work the following means of getting information:

1. The exchange bureaus of local associations of credit men and the central bureau of the National Association.
2. The reporting bureaus and boards of trade in various lines, such as the Hat and Cap organization, the Jewelers' Board of Trade, the Lead and Oil Association, the Lumbermen's Trade Association, the Shoe and Leather Bureau, and many other lines, who serve their own membership.
3. The Credit Clearing House.
4. Inquiries from trade references. This class of investigation has for its object two important points: (a) to ascertain how the applicant for credit meets his payments—does he take cash discounts, pay at maturity, or is he letting accounts run past due? —and (b) to learn the aggregate of his indebtedness.

It will be apparent that considerable vigilance and careful thought must be given to this part of the credit file. The manner of payment may be determined with reasonable accuracy, but it is not always certain that the total indebtedness has been ascertained. This is because in so many cases not all the houses who are selling the

risk have been included in the clearing or have been reached by the inquiries. If he has given a signed property statement, however, the ledger information obtained as above may assist materially in verifying the accuracy of the statement as to liabilities.

Credit Interchange Bureaus

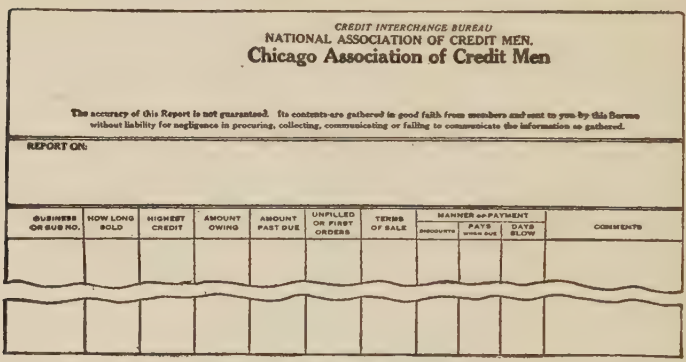
The credit interchange bureau system of the National Association of Credit Men is being developed with a view to securing the experience of all markets in which the credit applicant may be buying. The plan contemplates that the bureaus of the various local associations shall exchange with each other. There are about 100 local associations now maintaining such bureaus.

To make this interchange national in its scope has required much time, careful thought, and an immense amount of labor on the part of the interchange bureau committees of the national organization. Many problems have had to be solved in giving the prompt service required at a minimum cost. The charge for such service to members has been held at the lowest rate that would make the bureaus self-supporting. One of the most difficult problems grew out of the fact that a bureau in a large city might receive in one day 150 inquiries from its own members and 600 inquiries from the bureaus of other cities. As promptness is an essential element in this service, the labor involved in handling such a volume can be readily understood.

Chicago Bureau's Method of Handling Inquiries

Two forms used by the bureau of the Chicago association are here given. Figure 1 shows the form used for clearing the information collected on an inquiry from one of its own members. The replies received from the

various houses selling the applicant are tabulated on this sheet, which is kept on file. A copy is mailed to the mem-



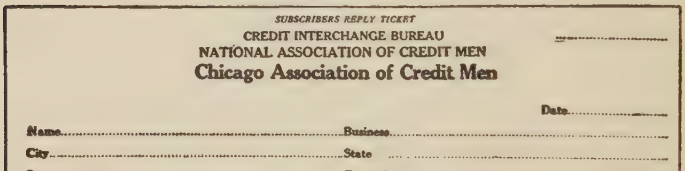
CREDIT INTERCHANGE BUREAU
NATIONAL ASSOCIATION OF CREDIT MEN.
Chicago Association of Credit Men

The accuracy of this Report is not guaranteed. Its contents are gathered in good faith from members and sent to you by this Bureau without liability for negligence in procuring, collecting, communicating or failing to communicate the information so gathered.

REPORT ON:

BUSINESS OR SUB NO.	HOW LONG SOLD	HIGHEST CREDIT	AMOUNT OWING	AMOUNT PAST DUE	UNFILLED OR FIRST ORDERS	TERMS OF SALE	MANNER OF PAYMENT			COMMENTS
							DISCOUNTS	PAYS WHEN DUE	DAYS SLOW	

FIGURE 1.—Form Used by Chicago Credit Interchange Bureau in Answering a Member's Inquiry.



SUBSCRIBERS REPLY TICKET
CREDIT INTERCHANGE BUREAU
NATIONAL ASSOCIATION OF CREDIT MEN
Chicago Association of Credit Men

Date.....

Name.....Business.....

City.....State.....

Street.....Formerly located at.....

Also uses style.....Successor to.....

Our experience as follows: REPORT AMOUNTS IN DOLLARS ONLY. First Order $.....Date of Last Sale.....

HOW LONG SOLD	HIGHEST CREDIT	AMOUNT OWING	AMOUNT PAST DUE	UNFILLED OR FIRST ORDERS	TERMS OF SALE	MANNER OF PAYMENT			COMMENTS
						Discounts	PAYS When Due	DAYS SLOW	

COMMENT: Place X in front of answer. USE CAUTION

☐Account Secured. ☐Pays by Notes. ☐Pays Drafts. ☐Makes Unjust Claims. ☐Returns Goods Unjustly. ☐Claim in Attorney's Hands.
☐Checks Protested. ☐Notes NOT Paid When Due. ☐Takes Excessive or Unearned Discounts. ☐Countermands Orders. ☐Collected by Attorney. ☐Refused, (Give Cause)

SPECIAL COMMENT:.....

Use back of this ticket for references, or names of houses (with complete addresses) known to be interested

CHECK.....if a copy of the final report is desired. NO.....

FIGURE 2.—Form on Which Members of Chicago Credit Exchange Bureau Make Reports.

ber making the inquiry. Each member of the bureau is given a number, and this number, appearing in the first

column on the form, is the only identification of the houses reporting on the risk.

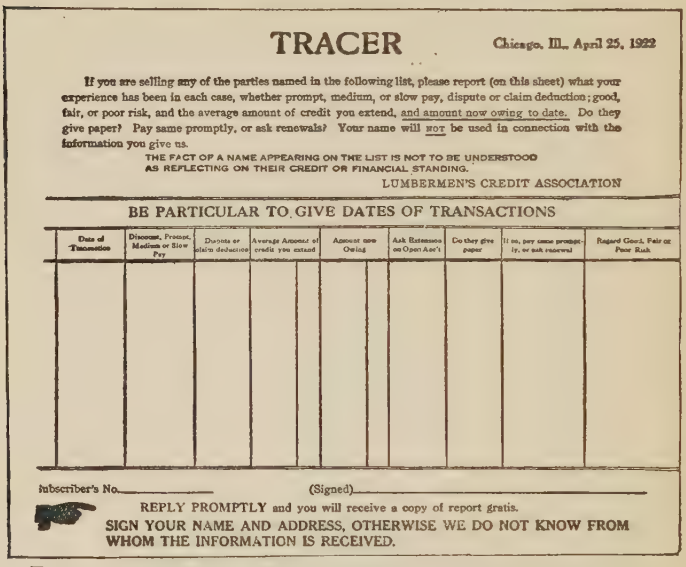
Figure 2 shows the form used by each house in making its report on the applicant being investigated, the information on which is tabulated on the first form (Figure 1). On inquiries from other bureaus this second sheet (Figure 2) is mailed direct to that bureau, just as received from the reporting house, the number at the lower right-hand corner being the only indication as to the source of the information. The bureau receiving such reports makes its own tabulation for its inquiring member. This plan is simple, practical, and effective, making a great saving of expense and labor in furnishing the desired information promptly. The National Association is carefully but energetically developing this Chicago system to cover all markets, which seems likely to become more effective than any other method in determining the extent of the purchases of a credit applicant and his aggregate indebtedness in all markets.

Trade Bureaus

Of the interchange bureaus for the various trade organizations, that of the Lumbermen's Association is perhaps as well organized and managed as any of them, in that it covers the various markets rather thoroughly and secures very general co-operation. In this line the accounts are for large amounts on the average, and credits, therefore, must be scrutinized with care. As freights are allowed on shipments in many cases, the delivery is at destination instead of at point of shipment, which may be considered as an advantage to the seller.

Two forms are here given which will indicate the method of clearing the information and the rather searching investigation contemplated in the reference on trade

inquiry reports. One form (Figure 3), called the "tracer," gives the daily list of firms on which information is sought. Each firm is given a number on the list and the members reporting on the names they are selling use this number in giving ledger experience in connection with



TRACER Chicago, Ill., April 25, 1922

If you are selling any of the parties named in the following list, please report (on this sheet) what your experience has been in each case, whether prompt, medium, or slow pay, dispute or claim deduction; good, fair, or poor risk, and the average amount of credit you extend, and amount now owing to date. Do they give paper? Pay same promptly, or ask renewals? Your name will not be used in connection with the information you give us.

THE FACT OF A NAME APPEARING ON THE LIST IS NOT TO BE UNDERSTOOD AS REFLECTING ON THEIR CREDIT OR FINANCIAL STANDING.

LUMBERMEN'S CREDIT ASSOCIATION

BE PARTICULAR TO GIVE DATES OF TRANSACTIONS

Date of Transaction	Discount, Prompt, Medium or Slow Pay	Disputs or claim deduction	Average Amount of credit you extend	Amount now Owing	Ask Extension on Open Acc't	Do they give paper	If so, pay same promptly, or ask renewal	Regard Good, Fair or Poor Risk

Subscriber's No._____ (Signed)_____

REPLY PROMPTLY and you will receive a copy of report gratis.

SIGN YOUR NAME AND ADDRESS, OTHERWISE WE DO NOT KNOW FROM WHOM THE INFORMATION IS RECEIVED.

FIGURE 3.—Form on Which Members of Lumbermen's Credit Association Report Inquiries to Bureau.

the tabulated information in the column form at bottom of the sheet.

The other form (Figure 4) is the inquiry on trade reference form used in securing the trade reports or experience from members on firms which they are known to be selling. An examination of the questions included in this form will show the thoroughness of the investigation which the bureau undertakes to make for its members. When a creditor has such a report from all the

TRADE REFERENCE

LUMBERMENS' CREDIT ASSOCIATION

SPECIAL CREDIT AGENCY FOR LUMBERMEN

Established 1876

Publishers of

Clancy's RED BOOK Service

608 South Dearborn Street

CHICAGO,..... 19.....

.....

.....

DEAR SIR:—

Please furnish us, in confidence, with what information you may possess and your experience with .....

..... he....ha.....referred us to you; an early reply with the desired information is earnestly requested.

Yours very truly,

Lumbermen's Credit Association

How long have you sold him or them? .....

Buy on open account or close account by note? .....

Do you require party to discount?..... When was your last shipment?.....

Terms on open account?..... Terms by note?.....

Make practice of making unjust claims based on quality or amount invoiced and demand deduction, which .....

Satisfactory in settlements?.....

Do you limit line of credit or sell him or them all they wish to buy?.....

Highest amount of credit you have extended?.....

How much owing you now?..... Amount past due?.....

Discount all purchases?..... Pay promptly as per above terms?.....

Medium pay, state how long over regular terms?.....

Slow or very slow pay, which?.....

Ask extension on account?.....

Ask extension on note or acceptance?.....

Do you have to draw draft to secure payment?.....

Refuse to give note and take overtime on account?.....

Have you been compelled to place account for collection or send your representative to collect, which? .....

Countermand orders without just cause?.....

What kind of goods do you sell him or them?.....

If you know, kindly state lines of business engaged in?.....

What conclusion have you arrived at from your experience and facts gathered as to credit, good, fair or doubtful, which?.....

PLEASE ANSWER FULLY EACH QUESTION THAT WE MAY FORM A CORRECT IDEA OF TRADE EXPERIENCE

FIGURE 4.—Form on Which Members of Lumbermen's Credit Association Report Trade Experience to Bureau.

houses selling the prospective credit risk, it becomes possible to make an intelligent decision on the applicant.

Other trade bureaus may cover the ground quite as thoroughly in their information blanks, but it is apparent that such interchange of information is very valuable.

Proper Use of Interchange Information

The credit man should treat this interchange information conservatively. If he places too much reliance on the experience of other houses he may unconsciously be allowing other credit men to pass on his credits in a degree; and these other houses may be following a more liberal credit policy than his house should adopt. The interchange information should be weighed in connection with all other conditions disclosed by the credit file.

Again, the reports from exchange bureaus and the Credit Clearing House should not be depended on as covering the entire market. In some lines, especially general stores and department stores, they may cover only a small part of the applicant's purchases. Further, this class of reports should not in any way take precedence over or take the place of direct inquiries addressed to the references given, or to the houses shown to be selling him by the salesman's report. These direct reports may represent the most valuable and important part of the trade information.

In 1918 a failure occurred in an eastern market of a firm in the clothing or textile line, which showed assets of about $2,600,000 and liabilities of $2,300,000, according to reports published in trade papers at that time. No credit man for an interested house, after this failure had occurred, would have been likely to defend the credit given by his house as justifiable under the ratio disclosed of assets to liabilities. It would have been interesting

to know, however, to what extent each credit man was influenced in his decision by the fact that other houses were extending large lines to this firm. No one house seems to have realized the great aggregate of existing indebtedness. Surely credit would have been refused had the actual condition been known as it should have been.

Such experiences throw a strong side light on the importance of carefully studying the facts disclosed by the trade interchange investigation. In the case of clearings through exchange bureaus and the Credit Clearing House the question should always be asked: To what extent do these organizations, through their members, cover the entire market in which the applicant is buying?

Value of Personal Interview

The personal interview with the credit applicant should always be had when possible. It is always helpful to the credit man to have the benefit of this personal contact and acquaintance as a basis for future correspondence. It adds to his experience and training in reading human nature, and he can learn many facts in a short conversation which might not be readily ascertained otherwise. In many houses when an out-of-town customer calls and is introduced to the credit man, he is asked to meet "our Mr. Jones." The credit man's title is not mentioned and the customer does not discover that he has met the credit man, unless something in the condition of the account needs discussion. Even then the customer may think he is talking to the auditor or treasurer of the firm. The friction or embarrassment often engendered by the thought that the applicant's credit is in question is avoided, and the credit man gets incidentally and freely all the information he may require.

In the case of large accounts which may present diffi-

cult decisions, it will often be well worth while to have a representative of the credit department spend a day with the customer if the distance is not too great. Such a visit may lead the credit department to decide to close the account at once to avoid a loss, or it may lead to a closer, friendlier connection and increased volume of business. Many houses are adopting this policy with all large accounts which involve any element of doubt and cannot be settled by the usual credit information; and such houses consider the policy a good investment.

Other Sources of Information

Many houses who have accounts with large corporations find that they can use to advantage as credit information one of the manuals now published annually giving data and statistics on such corporations.

Another source of information, which should be in every credit office, is the "Credit Man's Diary," published annually by the National Association of Credit Men. Questions will arise frequently in analyzing credit files which can be quickly answered by this publication.

CHAPTER VII

THE PROPERTY STATEMENT

Obtaining Signed Financial Statements

There are two propositions to be considered in connection with the property statement: (1) how to obtain the statement; (2) how to use it, and get all the aid which it can furnish in judging the credit.

A signed property statement may properly be called the key to the analysis of the credit file. It furnishes a base line, or starting point, in the investigation, because it will give many facts which will usually not be obtained in any other way. It is the standard by which many other items of information can be measured.

It is therefore important that the credit man make an effort to obtain it in all cases of close decisions if it is not included in the special report of an agency.

The credit man should develop tact and skill in requesting statements, and should have the proper mental attitude in approaching the proposition in each case. He should have the courage of his convictions on the subject, yet proceed in a courteous and diplomatic manner, whether by correspondence or personal interview. What he is asking for may prove to be as much a favor to the applicant for credit as to the house from which he is seeking credit.

Explaining Request for Statement

The request for a statement may be based on some or all of the following reasons:

1. The house would prefer to have the information concerning the resources of the applicant from himself direct, as it will be more reliable and correct than if obtained from other sources which may not be properly informed on the subject, or may be prejudiced or indifferent.

2. It is customary as well as beneficial to make such statements, as it strengthens the credit of the merchant who makes it. In furnishing credit to a merchant the house from which he is buying is giving him that which supplements his capital and in a sense is entering into partnership with him to the extent of sharing in the risk of his business.

3. The giving of statements inspires confidence and may strengthen his position if he should wish to increase the line of credit during the season. It may also form the basis for prompter shipments should the merchant desire to order more heavily on second orders during the rush season.

4. If the season has proved unfavorable or other conditions have developed, making it desirable for the merchant to have a short extension, his request might be considered much more favorably if his position were fortified by having given a property statement. This reason should be given only in cases where discretion may make it advisable.

5. The credit man may say that his own house voluntarily furnishes an annual statement of its own financial condition to all firms from which it asks credit, not only to strengthen its own credit but because it feels that such firms are reasonably entitled to this information. He is therefore asking no more of the applicant than his own house is willing to do for those who are interested in its finances.

Skill in Correspondence

The credit man in correspondence should avoid most diplomatically any semblance of timidity in making request for a statement. He should show a convincing belief in the reasonableness of his proposition. If he can skilfully inject into his letter the idea that he fully expects a cheerful compliance with his request, there is a force in his argument and a psychological effect to which many merchants will unconsciously yield. It is a part of constructive credit-granting to contribute constantly to the educational campaign which will bring about a universal compliance with the business custom of making an annual financial statement.

Where Persistence Won

The following correspondence will illustrate what may be accomplished by skilful yet persistent urging with a recalcitrant customer.

A Chicago house during the readjustment period following the World War, desiring to exercise proper leniency with all deserving debtors, in many cases found it necessary to revise credit files. One such customer had been running behind on his payments, and had always declined to give a statement to the mercantile agencies. He had been previously approached on the subject both by the salesman and the credit department, but he was positive in his refusal. The credit manager wrote him as follows:

Permit us to direct your attention to our August, September, and October bills, which are now due and payable, and a check to cover by return mail will be appreciated.

We also note upon reviewing our credit files, that we have not been favored with a late financial statement from you and we therefore are enclosing a blank, which we would be pleased to have you fill out in detail and return to us at your earliest convenience.

This letter brought rather a prompt reply, but the response was addressed to the salesman who traveled the territory instead of to the house. This will, perhaps, not seem unusual to most credit men who have had similar correspondence.

Enclosed we hand you a letter just received from your collector which explains itself. Of course we do not have to discuss with you the unusual circumstances which have existed for the past two years and which have resulted in the unusual condition that exists today. It would be sufficient to remind you that orders with all houses were from three to fifteen months behind, orders being filled piece-meal, when they were filled. We would naturally accumulate a volume of unfilled orders with you, the amount of which in dollars and cents could be hardly estimated. Without warning, everybody began shipping. Frankly, we have taken liberties with your account, presuming on our forty years of business relations, and tried to keep up with the accounts of comparative strangers, with whom we have dealt for only ten or fifteen years. It does not appeal to us to be paying interest on this investment, which just to the extent that it overstocks us, is a dead investment, because we do not feel that we are in the least bit at fault that this large account has accumulated.

Now we do not want any explanation or apology, because we believe we understand just exactly what the situation is, that your collector is expected to follow some system in his collections. We do think, however, that since justice should be tempered with mercy, rounding up delinquent debtors should be tempered with common sense. We do not expect, however, to furnish you with any statement. You have been getting along without any from us for thirty-five or forty years and you will have to worry along without it now. UNDER NO CIRCUMSTANCES will we furnish a financial statement to anyone.

The salesman in this case, following the sensible course of co-operation, promptly turned this letter over to the house; and the credit department, nothing daunted, made the following reply, which resulted in changing the customer's attitude and secured the information desired.

Copy of your letter of January 19, addressed to our Mr..... has reached the writer.

We are very sorry indeed to learn that you interpreted our request for a financial statement as a reflection on your credit standing, for, we can assure you, such is not the case.

We revised our credit files the first of the year and asked every customer, who had not voluntarily furnished us with a statement, to execute the form which we sent you, and yours is the first exception we have received so far. The request was general and we made no exceptions, irrespective of whether customers discounted their bills or not, hence our letter to you.

The fact that we extend you unlimited credit, give your orders preference and use our earnest endeavors to please you, we believe is conclusive evidence that we highly appreciate your business and desire to keep you on our books as a thoroughly satisfied customer; and if it is your ultimatum not to furnish us with a statement, we will abide by your decision.

We, ourselves, voluntarily furnish our creditors with an annual financial statement, inasmuch as we feel that a concern who grants us credit is virtually a partner in our business, as they furnish us the merchandise on credit terms, which enables us to successfully carry on our business, and, as partners, they are entitled at all times to be thoroughly familiar with the financial status of our concern.

In reference to the balance due us on your account, please do not worry on this score, for, we can assure you, your indebtedness to us does not cause us any uneasiness. We have implicit confidence in you, as you have always treated us fairly in the past, and we know that you will continue to do so in the future, and if you require a little extra time, you are heartily welcome to it.

We trust that our heretofore pleasant relations will not be marred by this divergence of opinion, but that you will continue to favor us with your valued orders, which, we can assure you, will have our preferred attention.

Always willing to serve you,

The customer then made the following reply:

In view of the statements contained in your favor of the 19th, we have decided that it would be only fair to recede from our former position and furnish you with a financial statement, which we are enclosing herewith.

It did seem to us that your former letter failed to give due consideration to the fact that we had just made you a good-sized remittance, as well as other facts that need not be recounted, but we will be very glad to consider the matter a closed incident and can assure you that our heretofore pleasant relations will not be marred by this discussion.

The Courage of Conviction

This correspondence fairly illustrates what is meant by diplomacy in correspondence, coupled with a firm belief on the part of the creditor firm in the justice and reasonableness of their position. They sought to make it clear that their request was made as a matter of business fairness and right. The correspondence also shows a good working basis of co-operation between salesman and credit manager. A comparison of the two letters from the customer indicates that he was "soundly converted." When the statement was received it showed that the merchant was not financially embarrassed, except because of having been caught with too large a stock of merchandise when prices began to drop. He paid up his past due indebtedness within two months after the statement was given. His reason for refusing the statement in the first place, therefore, was mainly temperamental, and this is perhaps true in many other similar cases.

It may throw an interesting side light on this incident to state that the "credit man" in this case was a woman.

Too much emphasis cannot be placed on the importance of obtaining signed property statements in all cases where the need of such information exists. When a customer can be persuaded to give one it establishes a feeling of confidence and a more confidential relation on both sides. A merchant may give a financial statement to an agency somewhat hurriedly, and in many cases when he

does not sign it his figures may be estimated; but when he fills out a form furnished by the house from which he is seeking credit, he is more likely to exercise care in getting it correct. In making a statement in this way he may also have the actual condition of his affairs brought to his own attention more clearly than in any other way.

Skill Necessary in Using Property Statements

A successful credit man of experience, in talking to a class in Credits, once said: "I would not give much for financial statements." Another credit man, equally successful and experienced, when this subject was under discussion, remarked: "Beware of financial statements."

Neither of these men was objecting to the policy of obtaining such statements. Each one meant that unless the statement is properly dealt with, it may be misleading and a source of danger. Each one meant that a statement should be carefully examined and an effort made to confirm or corroborate it.

In seeking to confirm the accuracy of a financial statement more will be learned about the actual condition of the maker than could be learned from any other source. If it cannot be found that the firm making the statement has the amount of assets claimed, or that the values given are not confirmed, or if the liabilities are evidently understated, then the statement loses force and cannot be relied on. Such a disclosure becomes valuable information, and, what is more important, the situation is discovered at the right time and the credit under consideration can be treated accordingly.

When a property statement has been received by mail or through a salesman it should be acknowledged, and if there is any opportunity for making a friendly sugges-

tion or comment upon any items contained in it, showing an interest in the firm giving it, more pleasant relations may be established.

Statements Obtained by Mercantile Agencies

It is claimed, and it is probably true, that at the present time a larger number of statements is being obtained by the mercantile agencies than is being given to houses direct. One reason for this may be the fact that during the course of years court decisions have made the giving of a statement to mercantile agencies carry the same binding effect on the maker as though given direct to the houses using the agencies' reports, for the latter are merely acting as the agents of the houses for which they are obtaining this information. This consideration, however, should not lessen the activities of credit men in endeavoring to obtain a signed statement in all cases where the mercantile agencies have failed to secure them.

Indirect Benefits

It is generally conceded that when a merchant has given a signed financial statement and later sees financial trouble ahead, he will be more likely to pay up the creditor to whom he has given such a statement, especially if there is a lingering doubt in his mind as to whether he could readily show the accuracy of the figures contained in that statement.

Another indication that the importance of the custom of furnishing property statements is being more generally recognized may be gathered from the fact that one association of retail merchants, in a convention recently held, passed a resolution urging the members to make annual financial statements to their creditors as a means of strengthening their credit standing.

In securing signed property statements the credit department in many cases is no doubt aiding the sales department, for when a merchant has given a statement to a creditor house, and it has been accepted as satisfactory, he naturally feels that his credit standing with that firm is good, and he will be likely to place as many orders as possible with that house.

Illinois False Statement Act

For many years the National Association of Credit Men has been conducting a legislative campaign for securing the enactment in all the states of a uniform law to punish the making of false financial statements in order to secure credit. In the state of Illinois such a law was passed. This law is as follows:

False Statement Act of Illinois

In Effect July, 1917

That any person who shall knowingly make and sign or whoever shall either directly or indirectly, or through any agency whatsoever, cause to be made any false statement in writing the contents and falsity of which shall be known to him with intent that it shall be relied upon, respecting the financial condition, or means or ability to pay, of himself, or any other person, firm or corporation, in whom he is interested, or for whom he is acting, for the purpose of procuring in any form whatsoever, either the delivery of personal property, the payment of cash, the making of loan or credit, the extension of a credit, the discount of an account receivable, or the making acceptance, discount, sale or indorsement of a bill of exchange or promissory note, for the benefit of either himself or of such person, firm or corporation; or

Who, knowing that a statement in writing has been made, respecting the financial condition, or means, or ability to pay, of himself, or a person, firm or corporation in which he is interested, or for whom he is acting, procures upon the faith thereof, for the benefit of himself, or of such person, firm or corporation, either or any of the things of benefit mentioned in this section at a time

when he knows the contents of said statement and knows that it is false; or

Who, knowing that a statement in writing has been made, respecting the financial condition, or means or ability to pay of himself or such person, firm or corporation, in which he is interested, or for whom he is acting, represents on a later day, in writing, that such statement theretofore made, if then again made on said day, would then be true, when in fact he knows that said statement, if then made, would be false, and procures upon the faith thereof, for the benefit either of himself, or of such person, firm or corporation, either or any of the things of benefit mentioned in this section, shall be guilty of misdemeanor and punishable by imprisonment for not more than one year or by a fine of not more than one thousand dollars, or both fine and imprisonment.

Prior to the enactment of this statute the law of the state (passed in 1874) was ineffective. The courts had so construed it that a conviction for its violation was practically impossible. The burden of proof was entirely upon the creditor, and under the laws of evidence a prosecution always failed. The new law puts the burden of proof upon the maker of the statement. The creditor has only to show that the statement was made for the purpose of securing credit, that relying upon it the credit was extended, and that the statement is false. A properly worded statement blank, such as is now very generally in use, showing that the statement is given for the purpose of obtaining credit, and that as written and printed it is true and correct, greatly simplifies the furnishing of proof or evidence required in a court proceeding. Many other states have enacted similar statutes and they act as a strong deterrent force against those who might be tempted to make false statements.

Credit men will fail to get the direct benefit of such legislation, however, unless they steadily follow the policy of seeking for signed statements. These laws are effective only where a statement has been given.

A Precautionary Measure

When a financial statement is received by mail the envelope in which it comes should be marked with the initials of the employee who opened the letter and the day and hour of arrival should be noted thereon. Should the statement afterwards prove to be false, this precaution will prove of great value in offering competent testimony that the mail was used to defraud. Without such memorandum, the attorneys for the debtor, by technical objections under the rules of evidence, may succeed in having the statement excluded.

A form of property statement blank now used by many houses combines a mailing envelope with the statement form. This insures that the evidence of receipt by mail shall always be in the credit file and avoids the chance that a separate envelope might be lost or destroyed by oversight.

Necessity of Investigating a Refusal to Make Statement

When a debtor refuses to make a statement either to the agencies or directly to the house from which he is seeking credit, the vital question arises: What is the reason for this refusal? Is it because he knows the situation that would be disclosed by the statement would lead to a withholding of credit, or is there some other reason for his refusal? The credit man should investigate this phase of the question with sufficient care to reach a correct judgment on the existing conditions or possibilities.

It is probably a fact that if all merchants seeking credit would make property statements as a basis for that credit, the number of failures would be greatly reduced and credit-granting would be placed on a more stable basis.

It therefore becomes of increasing importance that all credit departments should join earnestly in the campaign to educate applicants for credit to form the habit of giving the signed financial statement and to consider it as a proper business custom, which is beneficial and desirable to debtor and creditor alike.

CHAPTER VIII

THE PROPERTY STATEMENT—Continued

Care in Using Statements

The value of the property statement will depend almost entirely on the way it is treated. The credit man who said, "Beware of statements," admitted that he had in mind those credit-dispensers, who, finding a statement of assets and liabilities in the agency special report, glanced at it hastily, noted that the assets were considerably larger than the debts, let it go at that, and passed on the credit. There is no doubt that such a method is dangerous.

The credit man should consider that this statement was asked for and desired usually in a case requiring careful consideration and that his decision will probably hinge on the situation it will disclose. Therefore, the analysis must be careful and complete.

Form of Statement

The form of the property statement blank is of importance where statements are obtained direct. The National Association of Credit Men has for many years published forms adapted to different lines of business and any house considering the adoption of a blank to be used in its own credit department would find an advantage in securing a copy of the form recommended by the national office.

A consideration of the form used by the mercantile

agencies may be advantageous at the outset, as these forms have been arranged or developed by an experience of sixty years or more in soliciting signed statements. The

STATEMENT-FORM AA — STATEMENT AS A BASIS FOR CREDIT MADE TO — FIRM

THE MERCANTILE AGENCY, R. G. DUN & CO.

On the Financial Condition of _____

Location _____ *County of* _____ *State of* _____

Business _____ *Date to which all items of the Statement relate* _____ 19__

Full Names of all Partners, _____ Age ____ Married or single ____

How long in business here? _____ Whom do you succeed, if anyone? _____

Where from, Town and State? _____

Former occupation? _____

Ever failed? _____ If so, when and where? _____

ASSETS. (Where no figures are entered use the word NONE)		LIABILITIES. (Where no figures are entered use the word NONE)	
Merchandise on hand at cash value,	$	For merchandise not due (open acc't),	$
Outstanding acc'ts at realizable value,		For merchandise past due (open acc't),	
Notes receivable at realizable value,		For merchandise (notes payable),	
Cash on hand,		Loans from bank,	
Cash in bank,		Loans from friends or relatives,	
Machinery, Furniture and Fixtures,		Other obligations, consisting of	
Other *personal* property, consisting of			
		Total liabilities,	$
Total available assets,	$	Surplus,	$

REAL ESTATE: Describe, locate and value separately, *and in whose name held*,

	$
Total value of real estate,	
Mortgages or amount unpaid thereon,	$
Equity in real estate,	$
Total worth in and out of business (according to our figures),	$

Is the statement of value of stock on hand made upon the basis of an inventory actually taken? And if so, on what date? _____

What in your opinion is the total amount of your assets and of your liabilities as they are at the date of signing this statement? Total assets, $_____ Total liabilities, $_____

Amount of CHATTEL MORTGAGES, if any, on stock or fixtures, $_____

If any of the above accounts are pledged, state the amount, $_____

Are there any existing liens on personal property not mentioned above? If so, what? _____

Contingent liabilities upon bills of exchange, endorsements, guarantees, etc., $_____

Annual business amounts to, $_____ Bank with _____

FIRE PROTECTION. State its general nature—public fire department, sprinkler system, fire extinguishers, night watchman, etc. _____

INSURANCE: On merchandise, $_____ On buildings, $_____

Did you ever suffer a fire loss? _____ If so, where and when? _____

Did fire originate on your premises? _____

Do you carry employer's liability insurance? _____ Sign here full name of Firm. _____

Date of signing statement, _____ 19__ By whom signed, member of Firm. _____

OVER

FIGURE 5.—Dun's Form of Property Statement.

form used by R. G. Dun and Company is given in Figure 5.

The outstanding fact concerning this form is the large number of items of information which the agency considers necessary or desirable in determining the credit and capital rating of the firm being reported on, and in making up a special report giving the facts and conclusions which dispensers of credit may consider vital or important as a basis for judging the credit risk. It is a bird's-eye view of the amount of information necessary in a greater or less degree in passing every credit.

Simple Form Preferable

At the same time the credit man who compares this form with the information usually furnished in a special agency report reaches the conclusion that all the items called for in the blank are not as a general thing included in the special reports, and are therefore probably not always stated by the maker of the statement. Consequently many houses, and especially the larger houses, seem to have concluded that it is possible to ask for too much information; and by using a form that is too complicated or too comprehensive, loaded down with all manner of details, they may defeat the primary object in view, viz., obtaining the statement.

This inference is drawn after examining a number of forms used by houses doing a large volume of business and who make a special effort to simplify the form in use, so that it shall call for only the most important items and shall not discourage at the outset the merchant who is called on to fill out and sign the blank. The form shown in Figure 6 is a composite from the blanks used by several such houses.

LIBRARY

An examination of this form will show that it covers what are usually considered vital points in an investigation, and probably even more information than usually

accompanies the special reports of the mercantile agencies which include financial statements. This view is of course

STATEMENT

Dated at ..... 19..

Firm Name .....

Address .....

Corporation ..... Capital Stock, $ ..... Paid in, $ .....

Partners Names ..... Married or Single .....

..... Married or Single .....

..... Married or Single .....

..... present the following as a true showing of ..... business affairs and financial worth at this date for the purpose of obtaining a line of Credit from

Adams and Brown, Chicago

ASSETS		LIABILITIES	
Merchandise at ..... Value	$	Accounts Payable Mdse. Not Due	$ .....
Accounts Receivable (good)	$	Accounts Payable Mdse. Past Due	$ .....
Notes Receivable (good)	$	Notes Payable	$ .....
Cash on Hand and in Bank	$	Borrowed Money from Bank	$ .....
Other Personal Property	$	Borrowed Money from Others	$ .....
		How Secured	
Total	$	Total	$ .....
	Net Worth		$ .....
		Date of Inventory	
Real Estate (exempt)	$	Insurance on Mdse.	$ .....
		Burglary Insurance	$ .....
Real Estate (not exempt)	$	Insurance on Other Property	$ .....
In Whose Name?		Annual Sales (last year)	$ .....
		How Long in Business	
Encumbrance on Real Estate	$	Bank With	

Are any of accounts receivable, sold or pledged? .....

References: (Houses from whom you buy on credit.)

.....

.....

.....

.....

.....certify that the above, as printed and written is correct; that there is no other indebtedness than above stated; and that .....will promptly notify said Adams and Brown of any change in .....business affairs affecting above statement.

.....(L.S.)

FIGURE 6.—Form of Property Statement Used by Several Commercial Houses.

subject to modification for those lines of business which extend very large lines of credit and which are in a posi-

tion to ask or demand that minute detail which is necessary to a very close scrutiny of the risk.

For the average retail merchant, however, to whom the filling out of a complicated statement blank would be quite a task, a form combining simplicity with only the vital details seems to be the most satisfactory and successful.

Annual Sales—Key to Statement Analysis

As a starting point in the analysis of a statement it should be kept in mind that this cannot be done in a perfunctory or hasty manner. The statement is being relied on usually in doubtful cases, and in testing it for accuracy and for what it really shows as to the condition of the applicant's business, comparison should also be made with all other items of information in the file.

The key to the analysis of the statement is the amount of annual sales. If this item is not given in the statement, every effort should be made to obtain it, for it is a standard of measurement by which other items should be tested.

In the analysis of assets, the first item as a rule is merchandise or inventory. An important item of information, usually shown or required by the blank, is: Was the inventory taken at cost or market price? This question is vital when market values are fluctuating in a wide range. In normal times it is safe to value it at cost price.

Important Points of Analysis

Compare the merchandise item with the average of monthly sales, taking into account the customary terms in that line of trade. How many months' sales are represented in the inventory, or merchandise on hand? If the

usual terms in the line are 2/10 net 30 or net 60, how many months' sales are on hand? This test may show:

1. Whether the investment in merchandise is too large.
2. If the amount is excessive it may indicate a failure to buy carefully, or that there is too much dead stock being carried.
3. It will show whether the rate of turnover on capital invested is in keeping with good merchandising in that line of goods.
4. If there is an overstock of merchandise the comparison with monthly sales is usually the only method by which that fact may be ascertained.
5. Compare the amount of merchandise with insurance carried.
6. Note the date of the inventory. Is it at the close of the season, when merchandise should be at low-water mark? If the statement covers a manufacturing business the inventory should be given under three headings:
   (a) Finished goods.
   (b) Goods in process.
   (c) Raw material.
7. Supplies should never be included in a manufacturing inventory; they are not quick assets, but belong in the expense account.

Pricing the Inventory

In such an inventory the manner of pricing should always be given. In a manufacturing inventory of a going business "finshed goods" can always be regarded as a quick asset. They usually will be quickly sold. Goods in process may not be so readily liquidated. It may be difficult to estimate how much additional cash must be put into labor and material to get them ready to market.

Raw material may be readily salable, or it may have scarcely any value at all under liquidation. The character

of the business will determine this. Bar iron and steel of regular market sizes may convert quickly into cash. So of textile goods, if they are in pieces not yet cut. But if the material is of special designs, shapes, or sizes adapted only to use in the particular patented specialty article being manufactured by that firm, it might prove entirely unsalable and unusable elsewhere and therefore worth only junk value under liquidation. It becomes a matter of circumstances with each particular case.

Further, in regard to merchandise or inventory, is it an actual inventory, or only a book estimate? When the amounts given in any statement are in round numbers, omitting dollars and cents, it is usually evidence that the values are estimates and not actual figures, and such statements raise a doubt at the start. By a study of the merchandise item in statements, the credit man will become experienced in determining whether it is too high either from overbuying, from dead stock, overpricing, or deliberately overstating.

Accounts Receivable

A first consideration of accounts receivable should determine, if possible, that they all result from merchandise transactions and do not include liabilities of individuals or members of the firm which may be uncertain as to maturities or value. These latter accounts should be eliminated if they can be identified.

Next compare the receivables with monthly sales, taking into account the customary terms in the line. If sixty days represents the longest term, are there more than two months' sales outstanding? Keep in mind that in most lines of trade at least one-half the customers will take cash discount on the average. Therefore accounts receivable representing sales for two months or more will indicate

that either unwise credits are being given, or collections are being neglected, or both. The firm may also be carrying doubtful and worthless accounts as live assets.

If the usual terms are thirty days net, then more than one month's sales outstanding will indicate that something is out of balance, or that the business is not being well managed. Where the policy of the house is to sell on longer terms than regular, or to grant extensions, the chance for loss and shrinkage is greater.

Notes Receivable

Under the item, "notes receivable," the first question to arise will be, does the character of the business and its usual terms of sale warrant taking note settlements? Are the notes taken in the regular course of business, and is it customary in that line? If not, then this item may represent extensions on accounts already past due, and put into note settlements so that they are drawing interest. These are not a desirable asset, as they may be doubtful.

The same test should apply to notes as to accounts—are they the outgrowth of merchandise transactions in the usual course of trade? If they are in settlements of loans to individuals or to cover overdrafts on accounts by members of the firm, they should be eliminated as quick assets. If trade acceptances are being taken by the firm and classed as notes, the statement should indicate the fact.

Fixed Assets

This usually includes real estate, buildings, machinery, and tools.

A first consideration of this item is that it is not a liquid asset and not available for paying bills. The next question is—how much of the firm's capital or resources is tied up in this item? Is the investment out of propor-

tion to the resources, making the firm short on working capital? Is there a bond issue or mortgage against the property? If not, this item might be of some value as a last resort in case of any financial difficulty; but it should be considered only as a secondary line of defense.

Is there a charge-off against buildings and machinery for annual depreciation, and is it adequate? This applies to manufacturing plants. A good plant free from encumbrance might give the owner additional working capital in an emergency through the medium of a bond issue or mortgage.

This item in the case of a retail merchant might mean that he owns his place of business. It will always be a question whether he is better off for having a part of his resources invested in that way. If he owns a flat building, living upstairs and having his store downstairs, and the building is located on a business street where appreciation of values helps him out, it may prove a good investment. He can stay there as long as he wishes and no competitor can bid his lease away from him, forcing him to move at the expense of a loss of trade.

If, on the other hand, he has bought a building on contract, just for the sensation of owning real estate, and must pay so much every month or lose his investment, his condition may become precarious. If in keeping up the monthly payments he begins to lose out on cash discounts, gets past due on his merchandise purchases, and his credit becomes impaired, he may lose out entirely. It becomes a question of circumstance, judgment, location, and amount of capital the merchant may have accumulated before venturing on a real estate investment.

In a country town the risk of investment may not be so great, but the majority of merchants seem to be more successful as renters, keeping their resources earning 36

to 50 per cent per annum on cash discounts. In the larger cities there is always the risk of special assessments, the shifting of the business center, the building of an elevated railroad, an order for track elevation, or the changes in a residential district, which add to the risk of ownership of real estate.

Liabilities—Accounts Payable

In considering the liability part of the statement a primary fact claims attention. There will be no shrinkage on these items. If there is any change, it will be an increase.

Are any of the accounts payable past due? If the statement does not cover that point it may be learned from other information in the credit file. It is a vital fact to be determined if possible.

The next step is to compare the amount of this indebtedness with the merchandise account. This test will show whether the firm is taking cash discounts or not, for if it owes an amount equal to any considerable part of the merchandise it is not only not discounting but there may be evidence that part of the indebtedness is overdue. A comparison with the monthly sales will give a very close estimate as to what the monthly purchases should be, making due allowance for stocking up on seasonal requirements.

Any indication that the firm is not discounting its purchases raises a very material question at once as to its credit standing. It indicates a lack of working capital and it may be a symptom of more serious weakness.

Notes Payable to Bank

"Notes payable," if of any considerable amount, is a cause for searching investigation. The notes to bank and

those given for merchandise or other indebtedness should always be stated separately. It should always be shown whether the notes to the bank are secured and how. If there is a credit report from the bank it should be studied in connection with the indebtedness to the bank. Is the latter prepared to continue this line of banking credit, or is it likely to be withdrawn? Is the paying record of the firm satisfactory to the bank? If they have taken security for their loan, it is a sure indication that the bank does not consider the credit standing of the firm satisfactory on its own name alone. The amount of the bank loan should be compared with what would be a reasonable requirement for bank accommodations.

Other Notes Payable

If notes payable are for merchandise, why have they been given? If the line of business requires long terms on the purchases, the notes may be given in accordance with terms of purchase contract, and for the convenience of the creditors. Such an arrangement would be entirely regular though it would indicate that the purchases were not being discounted. If they are trade acceptances entered as notes, then the transactions would not indicate any weakness of credit position. If, however, these notes represent settlements of past-due purchase accounts and are drawing interest, it ordinarily indicates that the credit of the firm is being strained. The credit man should be sure that he knows just what this situation really means.

If there are still other notes, to individuals or to friends, it should be known whether such notes are secured and how. The nature of the transaction and the consideration for which the notes were given should be disclosed and the dates of maturities, if they must be paid when due, should also be shown.

Other Liabilities

If there is any bond or mortgage indebtedness the maturities should be shown, and the ability of the firm to meet such obligations at maturity be carefully weighed. Is a reserve fund being established for that purpose?

Does the statement show any accrued liabilities, such as a reserve for taxes? Such contingent liabilities usually exist. Another form of contingent liability should be investigated. Some firms take note settlements and trade acceptances from their customers and discount such paper with banks. A certain amount of contingent liability follows the indorsement of such paper and this should be considered.

Danger from Sale of Accounts

A question that appears or should appear on all statement blanks has a very important bearing: "Have any of your accounts been sold or pledged?"

There are firms which specialize in this line of business, and in soliciting prospective customers they use the argument that the sale of their accounts can be handled in a confidential way and without publicity. The argument is also used that the money obtained as proceeds of the sale can be used in discounting purchases and the transaction therefore will be very profitable. Following out the thought of no publicity sometimes leads the firm selling their accounts in this way to keep them on their books as an asset, while the cash received from the sale shows as a liability.

Public accountants who have had occasion to audit the books of firms selling their accounts receivable in this way comment on it as a dangerous practice. Cases have been cited where the handling of business in this way has cost the selling firm from 25 to 30 per cent for the use of

money. Having once commenced following this policy, they find it exceedingly hard to discontinue it. The experience of credit men with the plan has been uniformly unsatisfactory; hence the answer to the question regarding this situation has an important bearing on the customer's credit.

Uninventoried Merchandise

Under the heading of merchandise liabilities it sometimes happens that at the close of the season and just before inventory time in certain lines, considerable quantities of goods are bought and have already been received. They are not inventoried, and the invoices are not entered up until the following month. The houses consider that one offsets the other. But creditor firms in such lines of business have questions in their statement blanks to bring out this situation, because under such a method, a merchandise liability, sometimes for a large amount, has been actually created though not shown on the books.

Ratio of Assets to Liabilities

In endeavoring to verify the accuracy of a financial statement every part of it should be carefully scanned in its relation to every other part, as well as compared with all other information in the credit file.

It is usually considered, in comparing assets with liabilities, that a proportion of $2 of assets for every dollar of liability is a safe ratio, and there are very few cases where this would not be within the bounds of safety. In making the comparison, however, only the actual liquid assets should be considered and they should first be subjected to a reasonable shrinkage.

In some lines of business and with some firms many credit men consider a proportion of $1.50 of assets to $1

of liability as a safe ratio. This, however, would probably not be accepted as a general rule.

In testing the general situation revealed by many property statements where an element of risk seems apparent, the credit man may find it an aid to decision to ask himself this question: "Can I take this business under the conditions disclosed by this statement and make it pay out; and just how would I do it?"

If he cannot figure out the way to reach the desired result, perhaps the maker of the statement is not going to be able to work it out successfully either.

How Statements May Save Loss

From the foregoing method of analyzing a statement, the credit man may draw the following inference: If so much care is required in reaching a decision on a credit when a statement has been furnished, how much more difficult would it be to reach a correct judgment without the aid of a statement.

The credit man previously referred to, who said, "Beware of statements," submitted two examples from his own experience to illustrate the care which must be exercised in scrutinizing the assets and liabilities in a signed financial statement. Both cases developed in checking up the orders for the approaching season, and in each instance there was reason for a close investigation because of the manner of payment on the indebtedness from the previous season.

One statement was as follows:

Assets

Cash on hand	$ 130.60
Accounts receivable	1,806.72
Furniture and fixtures	2,690.00
Merchandise	33,517.91
Total	$38,145.23

Liabilities

Notes payable to bank	$ 8,500.00
Notes payable for merchandise	12,338.20
Due bank (overdraft)	21.23
Surplus	17,285.80
Total	$38,145.23

By the ordinary tests this statement showed a ratio of assets to liabilities almost two to one. The furniture and fixtures item was eliminated as not being a liquid asset available for paying debts, but this still left a reasonable excess of assets. The merchandise item was out of proportion, but the difficulty in securing merchandise in the year in which the statement was made, because of scarcity of material and the rapidly advancing prices, did not make the size of the inventory subject to serious criticism. Stating the figures in dollars and cents gave the statement the earmarks of having been taken from the books and of showing an actual and not an estimated inventory.

In comparing the statement with other information in the credit file, the report from the bank with which the merchant did business came under scrutiny. This report was not very definite, merely stating in effect that the firm had been in business for many years with a record for meeting their obligations. Comparing the size of the bank loan with the cash on hand and the other indebtedness, the credit man determined to write the bank stating the amount of the order he had under consideration and inquiring if the bank would tell him whether the amount of their loan to this merchant was in proportion to his usual borrowing line and whether they expected to continue to extend to him this amount of banking accommodation. The bank did not reply to the letter. The credit man inferred from their silence that they contemplated closing out their loan. He decided to turn down

the order, and collect what the merchant then owed his house as quickly as possible. He succeeded in carrying out the plan.

A fortnight later he received an agency report stating that this merchant was financially embarrassed. The assets were believed to be about $15,000 and the liabilities were estimated at about $33,000. By having a financial statement and by making the proper analysis of it the credit man felt that his house had escaped a loss, and that the statement was evidently false.

Another Example

The other case represented a different situation. The statement was as follows:

Assets

Merchandise on hand at cash value	$24,000.00
Accounts at realizable value (collectible)	4,000.00
Cash	500.00
Total	$28,500.00

Liabilities

Accounts payable for merchandise	$ 5,000.00
Notes payable (to bank)	2,000.00
Capital	8,600.00
Surplus	12,900.00
Total	$28,500.00

This statement showed assets amounting to about four times the liabilities, but the figures were given in round numbers, indicating that they were estimates. The "accounts payable for merchandise" attracted the attention of the credit man at once, and on calling for the ledger information he found that this merchant was then owing his house about $5,900, and the credit file indicated indebtedness to other houses of several thousands of dollars. The statement was false on its face.

Name	CAUTION	TERMS
		Regular
		Cash in Adv.
Address	See full report	C. O. D.
	Limit Date Authorized by	Do not lap bills
Successors to	$	Acct. opened

Statement Received	Statement Refused	Refuse Information to Agencies

BRADSTREET	DUN	I. & S. B. of T.	ATTORNEY	BANK
Last Rec'd	Last Rec'd	Last Rec'd	Date	Date
Rating	Rating	Rating	Amount	Amount
			Good Fair Bad	Good Fair Bad

In business here since	Getting ahead	Running behind	Holding own	Prospects

Record of Suits	PERSONNEL	RESOURCES		PAYMENTS
	Character	Ample	From statement to	Reported prompt
	Ability	Owe moderately	Date	Reported Slow
	Habits	Owe Heavily {Bank / Mdse.}	Cash and Rec'bles	Reported Discount
	Attentive to business	Very limited	Merchandise	Rptd settled by note
		Insufficient capital	Quick liabilities	Reported very slow
	Corporation	Agencies estimate net worth	Bonded Debt	TRADE
	Partnership		R. E. Mortgage	H. C.
			Chattel Mortgage	Payments
				Risk

Record of Judgments	REMARKS:

FIGURE 7.—Credit Brief.

Without the statement this probable intention to defraud might not have been discovered in time. The account of course was closed as quickly as possible and the pending order was courteously turned down.

Very many large houses with a large number of customers find it advantageous to make a summary of the information obtained through the credit file by means of what is called a "credit brief." The form given in Figure 7 is used by a house in the steel and iron trade.

When this brief is checked up by the credit man himself, or by the assistants who pass on credits in various territories, it leads to a closer familiarity with the accounts and greatly expedites the handling of orders.

CHAPTER IX

WHY MEN FAIL IN BUSINESS

Percentage of Failures

It has been frequently stated either by platform speakers or in written discussion that from 90 to 95 per cent of those who engage in business fail sooner or later in their business. This statement was made usually for moral effect or to emphasize some other argument.

Any business man who weighs the import of the statement will decide that it is not true. He knows that if any large percentage of those to whom he extends credit were unavoidably to fail, his own enterprise could not succeed.

Some years ago a credit man desiring to know the facts concerning the above statement addressed a letter to the Bradstreet Company, asking whether any definite statistics could be obtained as to the number of those who fail in business.

The agency wrote a letter in reply of which the following is a summary:

In answer to your inquiry we beg to say that at the very outset we must determine as to what is meant by failure in business. Is it failure to meet and pay obligations in full? Or is it simply failure to succeed in a mercantile undertaking?

There are two classes who are considered unsuccessful—one composed of those whose creditors share their losses; the other, who, while meeting their business obligations, lose their capital wholly or in part and are recognized as having been unsuccessful.

Of the first class Bradstreet's is in possession of very complete figures covering a long series of years. Examining our

records we find that the average failures for each year is about 1% of the firms rated in our volume. In answer, therefore, to the question, "Do 90% of all persons, who engage in business, fail to pay their debts?" we would say emphatically, "No." The evidence we have collected indicates that the average business lifetime of firms is about fifteen years, and you can therefore quickly determine from this that 15% of those who engage in business fail and fail to pay all of their debts.

If your question is so broad as to include both classes—those who fail to pay all their debts and those who fail to succeed—then the percentage would be larger, but how much larger, it would be impossible to determine.

Causes of Failure

The Bradstreet Company has published annually for many years a pamphlet which they call "A Record—Not a Prospectus." This gives the statistics of failures for the United States and Canada. These failures are classified according to the causes which produced them. The causes are enumerated in two divisions as follows:

Class A. Due to faults of those failing:
- Incompetence (irrespective of other causes).
- Inexperience (without other incompetence).
- Lack of capital.
- Unwise credits.
- Speculation (outside of regular business).
- Neglect of business (due to bad habits).
- Personal extravagance.
- Fraudulent disposition of property.

Class B. Not due to faults of those failing:
- Specific conditions (disasters, wars, floods, etc.).
- Failures of others (apparently solvent debtors).
- Competition.

All students of credits are advised to secure a copy of this pamphlet for any year and give it careful study. The agency will furnish it on request. The benefit of such

study may be stated in this way: If certain causes are known by experience to result in failure, then the examination of credit information should determine whether any of these causes are in evidence as affecting the applicant for credit. If their presence can be detected, then the credit had better be refused. It becomes a question of recognizing the symptoms in time, and involves reasoning from cause to effect.

Study of Failure Statistics

In making such a study the relative importance of each cause may be determined from the tabulations made by the agency. In 1917 there were 14,139 failures in the United States and Canada out of a total of nearly two million names reported on. The table of causes with percentage ratio to the total is as follows:

	1917 United States	1917 Canada
Incompetence	35.5%	16.3%
Inexperience	6.8	6.2
Lack of capital	31.9	37.5
Unwise credits	1.9	2.3
Extravagance	.6	.3
Neglect of business	2.2	2.5
Speculation	.4	2.5
Fraud	5.7	5.9
	85%	73.5%
Specific conditions	11.9%	25.4%
Failures of others	1.0	.8
Competition	2.1	.3
	15	26.5
	100%	100%

In grouping these causes by the three C's for the United States:

Capital, or lack of it	31.9%
Capacity, or lack of it	47.4
Character, or lack of it	5.7
Within control of debtor	85%
Causes beyond control of debtor	15
	100%

Importance of Capital

Such a comparison provides a standard of measurement. In previous years "lack of capital" showed the largest percentage, but "incompetence" has taken the lead, probably because the year 1917 represented rising markets, when capital was subjected to less strain and when a larger number of persons entered business undertakings without sufficient experience. The percentage of fraud ("lack of character") is relatively low.

Another interesting test is shown by a table under the heading of "Capital Employed by Those Who Failed," which is as follows:

Total number of failures in the U. S. and Canada for 1917.	14,139
Total failures with capital of $5,000 or less	13,304
Total failures with capital of over $5,000	835

The failures with less than $5,000 capital were 94.1 per cent of the entire number.

This large percentage surely indicates that insufficient capital is a fruitful cause of failures in business, and this fact stands out so prominently that, as previously stated, one credit authority advances the theory that engaging in business without sufficient capital should be classed also as evidence of incompetence.

Against this theory is the claim, referred to in a previous chapter, that the great majority of successful merchants began in a small way with moderate resources and built up to their present financial strength. It is evident that all firms making such a record were content to

trade within the limits of their capital resources and that those who failed with capital ratings of $5,000 or less, easily made the mistake of overtrading on their capital and as a result met financial disaster.

One writer on credits, in considering this large percentage of failures in the class with little or no capital, thinks it possible that if the total number of firms reported as having less than $5,000 capital were considered, it might be found that the percentage of those failing would be no larger than with firms rated over $5,000. He admits that there is no convenient way to demonstrate the accuracy of this suggestion.

If anyone wishes to test this theory, it could be done by tabulating the firms reported in a few pages of a rating book and comparing the total of ratings having $5,000 and less with those having higher ratings. Such a comparison would clearly show that the proportions do not support the claim above stated.

Proofs of Incompetence

Inasmuch as so large a percentage of failures results from incompetence, inexperience, and kindred causes, a credit student making an analysis of a credit file should consider what symptoms or conditions indicate a lack of capacity. In making a tabulation of these causes, he would discover the following to be the most prolific:

Overbuying or careless buying.
Poor collection system.
Poor accounting methods, which includes a failure properly to figure profits and the cost of doing business.
Poor business location.
Lack of enterprise (sometimes called "dry rot").
Poor display of goods.
Lack of volume (slow turnover).
Wasteful advertising.

Under "inexperience" he would tabulate:

Unwise credit-granting.
Speculation outside of business.
Neglect of business.
Personal extravagance.

Injudicious Advertising

A few years ago the Chicago credit men in a certain line of trade discovered by interchange of ledger experience that all their customers in a good-sized town buying in their market were becoming slow pay. Most of them formerly had taken cash discounts. The condition was so general that it suggested some underlying cause that ought to be explained. They decided to send an investigating committee to locate the cause. This committee spent a few days in the town, and on their return reported that the merchants of that town were losing out as the result of unwise and excessive advertising. The conclusions reached were placed before the merchants and the necessary remedy suggested. The desired reform was accomplished.

A leading commercial agency calls attention to the fact that in 1917, 13,698 out of the 14,139 failures, or 96.9 per cent, had "very moderate," or "no credit" ratings. This left only 3.1 per cent for those who had good credit ratings. The smallness of the figure indicates reasonable accuracy of judgment in assigning credit ratings to more than two million firms in business.

Effect of Rising or Falling Prices

The readjustment of business conditions following the World War was attended by such sharp and violent contrasts in prices, demand, and production as the present generation is not likely to experience again, and it is to

be hoped that a similar situation will never recur. The student of credits will find it instructive in considering causes of failures, to compare the experiences of a rising market, such as prevailed in 1919, with the experiences attending a violently falling market which developed in 1921. This comparison may be grasped more completely if stated in tabulated form. The statistics for the two years mentioned are here given for the United States and Canada:

	Rising Market 1919	Falling Market 1921
Total number of failures	6,141 (100%)	22,409 (100%)
Total with $5,000 capital or less	5,740 (93.5%)	19,730 (88.1%)
Total with capital of over $5,000	401 (6.5%)	2,670 (11.9%)
Total with moderate or no credit rating	5,995 (97.6%)	20,793 (92.8%)
Total with good credit rating or higher	146 (2.4%)	1,616 (7.2%)

It will be noticed that while the year 1921 shows an increase of more than 16,200 failures, the relative proportions throughout the tabulation for these two years are rather closely maintained, except in the second and the last classifications. Here the effect of the great losses resulting from shrinkage of inventories begins to become apparent. A detailed study of the causes of failures for the two years of 1919 and 1920 will present a very instructive comparison for the student and the credit man.

CHAPTER X

COLLECTING THE ACCOUNTS

The Collector

Every credit is extended on the belief that the account will be paid either at the cash discount date or at maturity. If paid in this way it was a safe credit. If not paid when due, it at once becomes a past-due account, to be collected. Then it requires the aid of the collector to demonstrate whether the account was a safe credit risk.

It is always preferable for the credit man to handle the collections, as is the case with the greater number of houses. He is more familiar with the accounts through having checked the credits in the beginning. If the collecting is handled by a separate department, it is important that the two departments work in complete harmony and close co-operation. Under either plan the matter of first importance is to have such a system of watching the maturities of the accounts that the debtor's attention will be called to it as soon as due. An underlying principle is that the best time for collecting an account is when it becomes due.

Watching Maturities

The system for watching maturities must be adapted to the character of the business, the number of accounts on the ledgers, and the method of handling the accounting. In some offices duplicate statements are made and

held in an alphabetical file for use in following up during the month. Other houses list them in a blank book, or a stenographer lists them on sheets for the purpose. Any method which involves the least labor for the number of accounts, and which will be most convenient for the person handling the collection and giving the list daily attention, is the method to install.

Some credit men follow the plan of looking through the ledgers once or twice a month. This takes time and may delay the work of the bookkeepers. A better plan for securing the co-operation of the accounting department is to provide a blank on which the bookkeeper may make a memorandum of any overdue account which he notices while posting. As these blanks are filled out they are passed to the credit man.

Handling the Accounts

As accounts reach maturity they automatically fall into one class. They are just past-due accounts and all will receive practically the same treatment, viz., a request for a remittance. A possible exception may occasionally arise where a new credit was extended with some mental reservation, and a notation was made by the credit man at the time, such as "Watch this account," or "Collect promptly." This marks that item for special and immediate attention. When a few days have elapsed the accounts which have not been paid and on which no response has been received to the first request for payment, begin to group themselves for special attention, and the credit man begins to apply to each the question: "Why has this account not been paid?"

In finding the answer to this question the method of treatment for each account is usually determined. In reaching a conclusion at this point the credit man keeps

in mind that he is not only getting the money which is involved, but holding the customer for the house as well.

If it is a new account, or if it is the first time that the customer has run overdue, the credit file should be carefully gone over again for a possible explanation of the situation. At the same time it will be advisable to call the attention of the sales department to the item, for some desirable information may come from that source. In the meanwhile the correspondence should be courteously shaped towards getting the customer's own explanation as to why the account is overdue.

Should the debtor not reply, and the sales department can suggest no reason for non-payment, it may be well to revise the credit file at once, and in doing so, by inquiries for ledger information, endeavor to find out how much he is owing other houses and how he is paying them. If he is beginning to run behind all along the line, it will be a signal to push the collection more urgently.

Reasons Given for Non-Payment

When this revised information has been obtained, and if the debtor has responded to requests for payment by giving excuses and a promise to pay later, the credit man is in a better position to decide on the course to be followed.

The excuses usually offered by such delinquents are time-honored and hackneyed. They set forth that collections are slow, business has not been up to expectations, the season has been too wet or too dry, or some unexpected condition has befallen the debtor. The credit man is seeking for results instead of reasons, and he must weigh correspondence of this kind judiciously. It may be a customer who is temporarily embarrassed and who is worthy of assistance. When that is the situation, the aid

is given cheerfully and the customer made to feel that the house is glad to give him the needed extension; but a definite date for payment should be named. All such cases will represent varying conditions, and each will require special attention.

In case such a customer has not been giving financial statements, it may be an opportune time for requesting a signed statement direct. When seeking an extension he should be willing to make full showing of his financial condition.

Advantages of Note Settlement on Overdue Accounts

It may also be best to ask such a customer to give an interest-bearing note. Inasmuch as it has been decided to extend the account in any event to a fixed date, the house will not be placed at any disadvantage by having it in note form. The debtor will pay interest on a note without demur, while he will all too frequently start an argument about paying interest on an open account. Even if he agrees to pay it on the account, he is apt to carry the feeling that he has been imposed upon. It is usually true also that a merchant will look upon a note as something that must be paid at maturity, while he does not entertain the same mental attitude towards an open account. A note offers another advantage to the holder over an open account: It can be discounted at the bank if the need arises.

It has been held by some credit men that asking for note settlement may be resented by the debtor as a reflection on his credit standing. Seemingly it should have the opposite effect. It shows the creditor has confidence that he will not need to commence legal proceedings before maturity of the note.

A note presents another advantage. It is an evidence

of admitted indebtedness, and should legal proceedings be necessary later, it can be sued upon without presenting technical proof as to sale and delivery of the merchandise. Still another advantage will result if the account happens to be difficult to collect and runs for a long period. An open account outlaws in from three to six years, depending on state laws. The Statutes of Limitations give a note from six to ten years, depending on the state.

Collection of an Embarrassed Old Account

In the process of collecting, some accounts will develop more difficult problems. They may be classed as those who are unable or unwilling to pay. As this condition develops, prompt action and urgent methods will become necessary.

It may be an old and valued customer who has been coming to the point of financial difficulty so gradually that it is now noticed for the first time. A few years ago a Chicago credit man prepared a paper on the subject, "When to Let Go of an Old Customer." It struck such a responsive chord in the experience of the credit men generally that it was printed and given a wide circulation.

Such cases present a difficult problem, and in deciding it, if the size of the account justifies it, a collector or the credit man himself had better call for a personal interview. This will determine more quickly whether the customer can be aided in working out of his difficulties or whether the time has come to make the collection in the quickest way possible. The visit in person, by a special collector or by the credit man, will apply to a new as well as to an old customer if the situation presents a problem for immediate and accurate decision. Another advantage may result from the visit in person. The man on the ground may get security for an extension.

Requisites of a Good Collector

A credit man for a large house, upon meeting another credit man, said: "Tell me of some publications on collection methods which will give me some new ideas, or some suggestions that I have not already discovered by experience. I have read everything I know of, but I do not find what I want." The other man admitted that he did not know of any work on the subject which would meet the requirement.

The fact remains that a good collector must be self-developed, and this equipment will require diplomacy, courtesy, resourcefulness, initiative, aggressiveness, persistency, and a careful study of the legal remedies which may have to be invoked. He must keep in mind the importance of his part of the work. Prompt collecting keeps working capital of his house intact, and every account collected is removed at once from the possibility of a loss. His slogan therefore will be: "Get the money."

Use of Form Letters

In carrying out his program by correspondence he will sometimes encounter the plan of using "form letters." Several writers have offered this plan as a guide to successful collection correspondence and they submit a series of such letters leading up gradually to a climax.

The student who considers this method will soon notice one or two points of inherent weakness in the plan. Too much time is lost in using a series of eight or ten letters written at intervals of five to eight days. A form letter is mechanical and lacks adaptability to special cases. Another inherent weakness is that the debtor discovers the form letter earmarks and the letters therefore do not "reach" him.

The oft-repeated incident of the debtor who was made the target of such a series of letters, who waited till the last one was written, and who then remitted with the explanation that he would have paid the account much sooner but for the fact that he had discovered the "continued story" tone of the letters and he wanted to be sure of having the entire series before he paid up, illustrates the point in this criticism.

Use of Draft

The first one or two letters sent to a delinquent debtor will have more or less similarity, but after that the individual method of treatment should develop rapidly. The third request for payment may be a notice that draft will be made through the debtor's bank. Or if the situation indicates that other creditors are pushing their claims, it may be a notice that if not paid at once the account will go to an attorney. This notice may take the form of a draft which is to be handed to an attorney by the bank if not paid within five days. Such drafts are furnished by the publishers of lists of attorneys, and they are very frequently paid to the bank within five days.

When the proposition to place with an attorney has been made to the debtor, it should in all cases be carried out on the date named. In placing an account for collection in this way, the credit man will realize that too much delay will sometimes jeopardize the collection. But he must also consider the fact that if the account is large enough to require a court of full jurisdiction, suit cannot be commenced until the next term of such a court. When that condition exists there is an opportunity to continue other methods until time for filing suit arrives. Every credit office should be supplied with means of obtaining information as to terms of court in various jurisdictions.

Selecting Medium of Collection

There will always be a time with every house when a decision will be made as to whether accounts shall be placed with local attorneys direct, using for that purpose the bonded list of attorneys who have been furnishing credit information, or whether some forwarding collection agency shall be used.

Both plans have zealous advocates. Those who favor sending to local attorneys direct argue that: (1) correspondence with the local attorney on the ground keeps the credit man constantly posted as to developments and enables him to offer suggestions from time to time, which may expedite a settlement; (2) the local attorney gets the entire collection fee, and will be more active in pushing for settlement than if he had to give one-third of it to the forwarding agency.

The advocates of the other plan contend that: (1) the credit man is relieved from some labor in following up the collection with requests for reports from time to time when the account is placed with a forwarding agency; (2) the local attorney, hoping to get additional business from the forwarding agency if he shows results, will be more zealous in pushing the collection.

Many credit men will try out both plans and adhere to the one which seems to give the better results. He will discover that both plans require some follow-up work on his part, and he may be better satisfied if he gives business to the attorneys who have given him credit reports on customers for the credit file.

Unresponsive Debtors

One of the perplexing cases which will develop in a collection correspondence with more or less frequency is that of the debtor who will not answer letters. The in-

genuity of the collector is then put to the test. One of the plans most frequently used perhaps is to telegraph him, asking immediate remittance for his past-due account and requesting reply by wire. A telegram carries a more urgent message than an appeal by mail and will nearly always result in getting some form of response.

A few years ago the national office of the Association of Credit Men published an illustration of what is involved with a debtor of this class, as follows:

A Credit Problem.—When the credit man checks gilt-edged buyers and receives payment on a discount basis, or promptly at maturity, his work is easy and requires no special skill, but when a risk gets into a dangerous situation, and it is a question of extricating one's self, then the test of skill and efficiency is brought into play.

A case in point was cited wherein merchandise is bought on 60-day terms, amounting to $300. At maturity a statement is sent, but no reply is forthcoming. In ten days a second statement, with a polite request for remittance, is mailed, but brings no reply. In twenty days a draft is drawn, which is returned unpaid, without explanation. A strong request for explanation and remittance follows, with no better result, so that at the expiration of forty days the credit department is confronted with the question, "What shall be done with this account?"

Individuality of Appeals

The unresponsive debtor has evidently always been a great trouble to the credit man. Many years ago there was published in the Bulletin of the National Association of Credit Men an incident showing how one credit man stumbled onto an idea which worked well in one case at least. He had a debtor named William Rose, who resisted all efforts to get a response to letters, and maintained a masterly silence. One day when this case came up again in the file, an inspiration came to the credit man and in a kind of desperation he wrote:

Oh, William Rose, nobody knows
How much we long to hear from you;
So William Rose, dig in your clothes,
And send us quick the amount that's due.

Whether the astonished William was jolted out of his rut by this effusion, or whether he dreaded the recurrence of such a poetical attack was not made clear, but according to the narrative he remitted by return mail.

The incident, however, carries a psychological application. In collection correspondence better results will be obtained when the credit man can break away from the stereotyped and conventional form of letter which has lost its compelling force. It has become threadbare through continued use and its tone very familiar to the debtor. Put originality and individuality into the appeals and the debtor will respond because mental processes are turned into a new channel. The credit man should put into his letters a tone of confidence and belief that the debtor is going to pay, and pay now; the matter is so important and urgent that there is no other way out of it. He may develop this thought until his letters will carry an incentive that is almost hypnotic.

Defects in Remittances

In the handling of collections a credit man will often find in the mail a check from a slow customer, which is unsigned. If he sends it back for signature delay may ensue. He may prefer to draw a sight draft, attach the check to it, and send to the customer's bank for collection. Or he may deposit it in his own bank with an arrangement to obtain the maker's signature when it reaches the bank on which it is drawn.

A check may be received reading one amount in the body of the check and a different amount in figures. If

one of these is the correct amount and the sum which the debtor intended to pay, the credit man will put an indorsement on the check guaranteeing it to be for that amount and deposit it.

A check will come back unpaid marked "Not sufficient funds." The credit man requests his bank to put this check through again, and if its return was merely from oversight it will usually be paid on second presentation. If, when the check was given, the house parted with the possession of something of value in exchange for the check and it later proves to be worthless, it comes under the operation of the "bad check law" now in force in most states, and the maker of the check is subject to indictment. These laws are now effective in punishing this form of fraud.

Where the maker of such a check is hard-pressed for funds, the credit man in some cases can leave it for collection with the bank on which it is drawn with an understanding that as soon as sufficient funds are deposited to cover the check the bank will certify it and forward to the holder. Or he may follow the plan of one credit man who had a check for $100 returned, "Not sufficient funds." On investigation he found that the bank balance lacked only a few dollars of covering the check. He deposited to the credit of the maker of the check enough of his own money to bring it up to the required amount, and then had the check certified. This would come under the head of resourcefulness in collecting.

The Personal Visit in Connection with Collection

The importance of making a personal visit was realized by the action of one credit man in a western city. A merchant in a town in an adjoining state notified all his customers that he was financially embarrassed, that

in endeavoring to get through his difficulties he had been forced to put a chattel mortgage on his stock. The holder of the mortgage had foreclosed, and the foreclosure sale was then being advertised. This credit man secured authority from other creditors to represent them in starting bankruptcy proceedings or in whatever action might seem necessary, and took the train.

On interviewing the debtor he found that he was actually insolvent and that the mortgage had been given to a relative more than four months before; and as the holder of the mortgage had waited till four months had elapsed, it would probably not be a preference if bankruptcy proceedings were taken.

In making his investigations the credit man found that the chattel mortgage had been recorded in the office of the clerk of the city court, which was a court of record. He found, however, that the law of the state required that such a mortgage had to be recorded in the office of the recorder of deeds at the county seat. He immediately went to the county seat and found that the mortgage had not been filed for record in that office.

He returned to the home town of the merchant and reported what he had learned and asked why the mortgage could not be declared invalid. He found the attorneys divided in opinion as to whether the wording of the law was mandatory as to filing in the county recorder's office, or whether any court of record would be sufficient. The law had not yet been passed upon by the Supreme Court, and nobody would prophesy as to how that court would guess.

The credit man then decided to act. He arranged for the necessary bond, took out a writ of attachment for the amount of his own claim, and had the sheriff levy on the merchandise of the debtor covered by the chattel

mortgage for over $20,000. At this point the relative who held the chattel mortgage came forward with a proposition to furnish the money for a satisfactory settlement with the merchandise creditors. After some negotiation the amount was agreed upon and the proper papers drawn for a cash setttlement and release of the attachment.

Without this personal visit, and the energetic action taken, as a result, the merchandise creditors would have received nothing.

Another Experience of a Visiting Collector

One collector for a packing house struck a difficult situation with a butcher who had become delinquent. The difficulty was that when the collector called, no matter at what time in the day, the butcher was always out. This collector used a horse and buggy in covering his territory, and on one of his calls, while hitching his horse across the street, he caught a view of the butcher stepping into his refrigerator. When he entered the shop and inquired for the owner, he received from the employees the usual assurance that the butcher was out. He replied, "Well, I have plenty of time; I will sit down and wait for him." After about ten minutes the employees suggested that it would be useless to wait, as it was not believed the proprietor would be back that day. The collector said he was in no hurry. The butcher stood it for nearly half an hour; then emerged from the ice-box and a settlement was reached. This collector now claims that this butcher was the original "frozen credit."

Firm Policy in Collections

The standing of a house in the trade is often determined in part by the policy and methods of its collection department. In one line of trade there is a house doing a

nation-wide business which has established such a reputation for itself that its customers understand that its terms are to be strictly adhered to and all accounts due are to be met at maturity or credit will be withdrawn. The line of merchandise handled by this house is not better than can be had elsewhere, though its goods are always reliable and its business methods fair. It is not in a position to be arbitrary because of any monopoly, but it has reached its enviable position through a process of educating its customers to carry out their part of the purchase contract.

These same customers, when dealing with other houses in the same line, will take liberties on terms of payment and make other unreasonable demands, but it is a matter of comment that this one house is immune from such practices, and it is generally admitted that it holds its trade without difficulty.

A credit man who studies closely the settlement of accounts will frequently observe that new customers in the first settlement will try out the house on some claim or demand, evidently to learn whether that house will be liberal and easy in its policy on settlements, or whether it will insist that all agreements be fairly observed. Such cases furnish an opportunity for educating the customer to live up to his contract, and the policy pursued on the first settlement will determine the attitude of the debtor for the future.

Initiative in Handling Collections

The successful collector will never cease to learn. His training will come by study, by reading, by interchange of ideas with others, but most largely through experience. What is here set forth is mainly suggestive and covering certain principles that will apply to the constantly shifting

conditions presented through situations developing daily in the conduct of any business. No set rules can be laid down to cover every problem that the student will encounter. What has been here suggested is designed to impress the importance of giving close and careful study to each individual case, and to emphasize the value and need of initiative in the successful handling of collections. "Get the money."

CHAPTER XI

TRADE ABUSES OR HUMAN NATURE IN BUSINESS

The Nature of Cash Discount

Incidental to the collection of accounts there will be many problems arising in every line of business, which will come to the credit manager for solution, decision, and adjustment.

The cash discount privilege originated when the practice of long-term credits was adopted. The merchant who was in a position to buy for cash was justified in asking some return for the use of his money and a discount for cash was the most convenient way of figuring the allowance.

The amount of such allowance varies with different lines, ranging from ½ of 1 per cent in ten days or net thirty days, to 10 per cent discount for cash in thirty days or net sixty days to four months. The first represents 6 per cent per annum, or the average bank rate of interest. The larger discounts may mean 40 to 50 per cent per annum for the use of the money, which is a higher rate of interest than any house can afford to pay, or needs to pay. Therefore such rate of discount is merely another way of making a lower price on goods, or it may be considered as an extra inducement, to those merchants whose credit is somewhat in question, to make a prompt settlement.

If this bonus for cash payment is offered to induce

quicker collections and to reduce the risk of losses from doubtful accounts, in actual practice the plan does not always accomplish what is expected. The good credit risk concerning which there is no question will always take the discount, while the poorer and doubtful risks will too frequently waive the privilege and let the account run to full maturity.

Cash Discount Likely to Stay

The cash discount system is too firmly entrenched to be done away with. Terms are usually fixed by the sales department, and they are adjusted to meet competition and trade conditions. A house in a line of merchandising having 7 per cent/10 days, or 6 per cent/30 days as the customary discount, notified its customers that cash discounts would be discontinued and all goods billed net, the prices having been reduced by the amount represented in the discount. It was expected that other houses in the same line would follow the lead and adopt the same plan, as it would result in eliminating cash discount abuses. They did not do so, however, and after a few months this house returned to the cash discount system.

Abuses of System

The merchant who stretches the cash discount terms and deducts discounts not earned, often does so without offering excuses, assuming as a matter of course that a house which appreciates his trade will gladly accord him such a small favor. Sometimes he will offer an explanation, and sometimes he will say frankly that he overlooked it, but in every case he expects the allowance and resents a refusal to make it.

The credit department therefore is under a handicap in resisting the claim, but the effort should always be con-

scientiously made as a part of the educational process which leads merchants to respect contract terms. A courteous letter written to the customer calling attention to the excess discount taken, expressing the belief that it was done by oversight, and showing the amount remaining due, which can be included in the next remittance, is probably the most effective method of meeting such cases, and will often secure the payment later on.

This especially applies to new customers who may be endeavoring to establish precedents. With old and desirable customers the discount may be allowed if the amount is not large. Yet a courteous letter should be written calling attention to the error which is allowed in this case, but with the understanding that it shall not be considered a precedent. There is always the chance that in "hewing to the line, letting the kicks fall where they may," a few cents may be saved in cash discount and a customer lost who can only be replaced at an expense of $100 to $200.

There are merchants who take discounts to which they are not entitled, in the belief that their credit standing is possibly in question, and that the discount will be conceded because the house is so glad to see the money that they will overlook the excessive discount taken. Such a claim should not be permitted.

A successful credit man, commenting on the cash discount system, said that from experience he placed debtors in two classes: "The one, having adequate capital and good credit standing, used these factors in exacting such close terms in prices, discounts, and other demands, that he seemed unwilling to let the creditor *eat*. The other, lacking capital and ability to discount, keeps the creditor constantly on the anxious seat, and seems unwilling to let him *sleep*."

While the matter of business policy will always be considered, the sanctity of business contracts should never be overlooked.

Interest on Past-Due Accounts

When a house decides to adopt the policy of charging interest on past-due accounts, the fact should be stated on all orders, invoice, and statement blanks, so that all customers have full notice that the rule will be enforced. Too many merchants will let the jobber or manufacturer furnish them with capital through overdue accounts carried without interest if the credit department permits the practice. And too frequently such debtors take an arbitrary position and will not even argue the point, practically saying: "You can take it or leave it." The question is closely related to collections. Prompt settlements do away with any question of interest. Where the debtor insists on his attitude and cannot be talked out of his unbusinesslike policy, or if he admits that he needs more time, a proposition to have him give an interest-bearing note may be the easiest solution.

Shortage and Damage Claims on Shipments

If the claim is made that goods are not as represented, or that they have been damaged—if there is any question as to the fairness of the claim, it may be best to have the merchandise involved returned for inspection and replacement. In such case, if the claim is unjust, the merchant will usually drop it and find some reason for not returning the goods. There may be claims, especially of misrepresentation, where the salesman and credit department may work together in making the adjustment of the complaints. If damage has been sustained in transit, the facts may justify a claim against the transportation company,

in which case a proper basis for the proof of claim should be reached. Claims for shortage should always be carefully investigated. An effective method of guarding against unfair claims of this character is to enclose with each invoice a shipping list showing what has been included in the package and that this list has been counted and checked by at least two persons whose initials are signed to it. This is notice to the consignee that the shipper of the merchandise is prepared to resist an unfair claim.

Returned Merchandise

Returned merchandise in many lines of trade is a very serious proposition, and perhaps the worst form of trade abuse. In such lines as clothing or garments, where a change of style will make the goods unsalable, it is an evil difficult to combat, especially when the goods are shipped back without permission. The shipment may be brought from the depot by a drayman and the goods are in the house before any one in authority learns of their return.

Such situations are best handled by credit and sales departments in co-operation, and while the question of trade policy may be involved, a firm stand on the part of the credit department is necessary, so that the merchant shall not form the habit. If it may seem advisable to take the goods, the credit for them should be on the basis of their value to the house at the time of the return, and a courteous letter written explaining the amount of the credit to be allowed and why. In extreme cases it may be best to ship the goods back promptly to the purchaser, or perhaps advise him that no credit will be given as there is no valid reason for the return of the goods and they are held subject to his order and at his risk.

Order Cancellations

The enforcement of a contract or order which a buyer determines to cancel is attended with so many difficulties that the cases where a seller resorts to the courts for aid are comparatively rare. In cases of signed orders a stipulation may be included providing that in case of cancellation the buyer shall pay to the seller 20 or 25 per cent of the purchase price as liquidated damages resulting from the cancellation. Such a clause in a contract will be enforced by the courts. With the great number of unsigned orders such a stipulation is not practical, but an understanding with the salesman to the effect that the order is confirmed and is not subject to cancellation or change, will be as binding as the order itself.

Situation in 1920

The question of cancellation of orders assumed overwhelming importance in 1920, when the slump in prices began to have far-reaching effect. The coming change in conditions took positive form by the end of the year 1919 after the jobbers and middlemen had made their purchases for the spring of 1920. At the time they were buying there was still a shortage of merchandise so far as surface indications showed. Purchasers were still being urged to buy under the allotment plan, which meant that they should specify a larger amount than they really needed, because they otherwise ran the risk of being without stock to meet the requirements of the spring season of 1920. As that season opened the retail merchants began to sense the impending decline. Many of them had already placed their spring orders in sufficient volume to meet the expected demand. They now began to cancel orders in whole or in part, and others withheld their orders. Jobbers and middlemen, seeing the coming danger, began

to cancel with the mills and manufacturers. These firms, having obtained advance information, had been shipping as rapidly as possible the full specifications on spring orders, the policy being to pass the impending loss on to someone else.

As the cancellations began to come in more rapidly, manufacturers began to urge the sanctity of contracts and to invoke a standard of business ethics which would compel the buyer to carry out his agreements and receive all merchandise shipped whether he would be able to pay for the goods or not. Jobbers and middlemen were thus caught between the upper and nether millstone. Manufacturers were demanding that buyers take their merchandise regardless of consequence, while the retail dealers were canceling their orders and returning merchandise which had already been shipped.

The rules of safe credit-granting seemingly were thrown to the winds. No one gave the order, "Save himself who can," but all acted on that principle. The result was a "debacle," but the situation was only such as always accompanies a sudden decline in prices.

Merchants Warned

Bankers and writers on economic subjects had warned business men that this readjustment must come and that the first symptom of its approach would be when consumers began to curtail purchases. This was the correct view. The government at that time held immense quantities of merchandise bought for war purposes. The authorities adopted the policy of holding this stock off the market, or selling it so gradually that conditions would not be unduly disturbed.

Notwithstanding these cumulative indications, too many merchants had either been heedless, or had not used

conservative judgment, in forecasting the future. Those who did not succeed in canceling purchases, or who attempted to carry out their contracts, sustained great losses. Many were forced into bankruptcy, as indicated by the great number of failures in 1921. Others attempted to get through under the burden by obtaining long extensions from their creditors and from banks. Such came under the head of "frozen credits," a new classification, devised to define more aptly these widespread conditions in business.

While credit departments were not responsible for the overbuying policies of business houses in this period, except in so far as they failed to closely diagnose the symptoms of the coming contraction and to sound a note of warning, some of them were responsible for the overbuying, for every order placed passed under the scrutiny of some credit man.

The situation indicated by the term "frozen credits" was freely discussed by all writers on financial and business conditions during the readjustment period of 1920 and 1921, and it was asserted by some that every "frozen" credit was a bad credit when it was granted. This claim is probably too sweeping. All houses, the strong and the weak alike, were involved in the congestion that resulted. It is fair criticism, however, to say that if the principles of sound credit-granting had been more closely followed by all, and proper importance had been attached to warnings and predictions that were being made and to the influences which were beginning to operate, very many of these orders would not have been accepted.

Handling of Trade Abuses

In the handling by correspondence of questions growing out of trade abuses, the policy and standing of the

house are to be considered and every letter requires careful consideration. The character or peculiarities of the customer and all the facts in the case should be gone over carefully, and every statement carefully tested for accuracy.

Hold the customer and his goodwill if possible, and yet protect the firm from unbusinesslike practices.

CHAPTER XII

THE BANKRUPTCY LAW

Previous Bankruptcy Legislation

A national bankruptcy law is authorized by the Constitution in providing that "Congress shall have the power to enact uniform laws on the subject of bankruptcy throughout the United States." This legislative power has been exercised four times.

The first law was passed in 1800. Its existence was limited to a five-year period by its own terms. It was intended to relieve those merchants and ship-owners who had lost through the destruction of the merchant marine of the country by the enemy's naval power. It was modeled somewhat after the English law, but after relieving those for whose benefit it was enacted it was regarded unfavorably and was repealed by Congress in 1803.

The second law was passed in 1841 and was understood to be a relief measure for those who had come under hopeless burdens of indebtedness through the financial disaster of 1837, which placed most of the people in the debtor class. This law also was repealed as soon as it was thought all debtors had received the necessary relief.

The third law was passed in 1867. It was intended to relieve those who had become burdened with debts because of the Civil War. This law was a more carefully considered enactment than either of its predecessors, but in securing its passage much was conceded to the States'

Rights advocates and to debtors. Because of its own inherent weaknesses dissatisfaction was engendered, which resulted in its repeal in 1878.

State Insolvency Laws

When there is no national bankruptcy law in existence, the insolvency laws of the various states are in force. The state laws remain in existence while a national bankruptcy law is in operation, though they are for the time suspended by its provisions. After the repeal of the third national bankruptcy law the number of states kept increasing and with the growth of the nation, interstate commerce rapidly increased in volume.

It was the difficulty of handling credits and collections under the different laws of the various states which set in motion a sentiment in favor of a permanent national bankruptcy law. It was called to the attention of Congress and the business houses of the country that all commercial nations had permanent statutes on this subject except China, Mexico, and the United States. Did the United States belong in that group?

Fourth Bankruptcy Law

This sentiment crystallized into action and the fourth bankruptcy law was enacted in 1898. This was intended to be a permanent statute, and while the advocates of the law were obliged to make many concessions, the law as passed is a practical and workable measure, well considered, and with the amendments which have been and may be adopted, it should be retained.

Many bankers were conscientious objectors to the law when adopted. They felt that a bank should be treated as a preferred creditor, because it loaned the money of depositors. There were also many wholesale houses,

having a well-organized legal department for handling collections, which preferred to operate under state laws allowing preferences. They were willing to take their chances, and being usually the first on the ground in cases of financial embarrassment, they collected their claims in full, and little, if anything, was left for other creditors.

Conditions Under State Insolvency Laws

The commerce of the nation has undoubtedly thrived and come to a sounder basis since this present law went into effect. The ratio of failures has remained uniformly smaller. Credit has been adjusted to the operation of the law. To repeal it and go back to the former chaotic conditions, with the insolvency laws of 48 states brought back into activity, would be a great shock to the credit system of the country.

Very few dispensers of credit now remember the difficulties encountered when the state assignment laws were in operation. The lawyers of Chicago had evolved from experience a definition of insolvency in those days as follows: "An assignment is a process of dividing the estate between the insolvent and his attorney according to law." Too often this definition fitted the facts.

The men who passed credits in Texas prior to 1898 have a vivid recollection of the insolvency law of that state known as the "Texas Deed of Trust." It would come into operation again if the national bankruptcy law were repealed. It provides for the following order of disbursing the insolvent estate:

Class A. Pay the expenses of this deed of trust.
Class B. Pay the local bank or banks.
Class C. Pay the relatives of the debtor.
Class D. Pay the local creditors.
Class E. Pay creditors outside the state.

It was a very exceptional case when any assets remained after Class C or Class D were paid.

Many other states have laws equally unfavorable to creditors outside the state. Such laws do not tend to promote or encourage interstate commerce.

Objections Raised Against Bankruptcy Law

Since the present bankruptcy law was enacted, a bill providing for the repeal of the statute has been introduced at every session of Congress, and at most sessions several such bills have been offered. Such a strong sentiment has always developed against the repeal that few, if any, of these bills have ever been pushed to a vote.

An association was formed at one time having for its purpose the repeal of this national statute. One reason given for asking its repeal is that when enacted it was understood to be a temporary measure, to be repealed as soon as all debtors had been relieved of old judgments hanging over them, and is to be considered an equivalent of the year of jubilee of the ancient Hebrews. The advocates of the law deny this temporary purpose of the enactment. Their contention seems to be supported by the purposes and provisions of the law itself. It would not be necessary to include in a law which was intended only to discharge debtors from old judgments, an elaborate enactment comprising 70 or more sections. Nor would the restrictions as to preferences within four months of bankruptcy (as in section 60) seem necessary for a debtor who had been out of business for many years and was seeking relief from a judgment entered against him ten or fifteen years previously. The whole structure of the statute indicates the purpose of a permanent law.

It is also objected that in its operation the law does not pay sufficient dividends. The advocates of the law

admit that the statute is not permitted in all cases to accomplish its true purpose or to render the service of which it is capable. That is not the fault of the law but of those who interfere with and hamper its operation. It is also shown that no other system of administrating insolvent estates will make better returns. Waste is unavoidable in insolvency and the state laws make a worse record as to average dividends returned.

Business Conserved

The strongest argument in favor of a national bankruptcy law is that it conserves business. A debtor who finds himself temporarily embarrassed and needing time in which to "turn himself" can go frankly to his creditors and arrange for an extension without any fear of an attachment being sworn out against him before morning. Under state laws he could not take such a chance, but would be obliged to stagger along under his burden until he met the inevitable. If he even whispered his condition to one of his creditors, the sheriff would be at his doors in a few hours with an execution and the results of his life work swept away. The creditor getting the execution first probably would secure payment of his debt in full. Perhaps the others would get nothing.

Many a business has been saved by the opportunity to get an extension for a short time. When the World War started in 1914 the cotton market was closed completely. This staple is the debt-paying crop for the cotton states, and the war came just at the time when the crop was about to come into the market. There was no market; there was nothing to do but wait. The then governor of Texas is reported to have said: "If it had not been for the steadying influence of the national bankruptcy law, Texas would have become a commercial hell."

While England has had a bankruptcy law since the time of Henry the Eighth, nearly 600 years, it has been repeatedly amended to adapt it to changing commercial conditions, and within the last fifteen years or so the complaints as to its administration were such that a commission was appointed to consider the objections to its operation and recommend such changes as would remedy the faults complained of. There was no demand for its repeal, but it was believed that amendments could be prepared which would adapt it to modern commercial conditions. This commission submitted its findings shortly before the World War began in 1914.

Preferences Prevented

Undoubtedly the most beneficent provision of the law is the prevention of preferences. "Equality is equity" and the fact that all creditors share alike in the distribution of the assets of an estate in itself creates a feeling of satisfaction and confidence. Litigation is reduced to a minimum, and this fact also makes for conservation of assets. If the bankruptcy cases which represent the process of getting rid of old judgments and that class of failures which show only liabilities with no assets are eliminated, then the average dividends on current failures will show better returns to creditors than could be possible under state assignment laws with the usual attachment proceedings and legal contests which were the common experience prior to 1898.

In a bankruptcy proceeding the debtor conveys all his assets to his creditors. The creditors accept this transfer or trust, in effect, when they file their claims and elect the trustees. They, therefore, become responsible for the administration of the estate. The criticisms and complaints as to the administration of the law for the most

part grow out of the failure of creditors to meet the responsibility placed upon them by the law. They do not see to it that the assets are so managed and cared for as to get the best returns possible. If creditors were not remiss in this respect the law would be found the best possible method for handling estates thus placed in their hands.

Handling of Estates Out of Court Permitted

Another benefit of the law not always recognized is the fact that it makes possible the handling of insolvent estates out of court. It secures the co-operation of all creditors because no one can take advantage of the others, and this concert of action produces the best possible results when estates are thus administered by a creditors' committee. It often happens that an estate handled in this way will pay out in full, and the business be turned back to the debtor in fairly good shape and as a going concern. The contrast between handling a temporarily embarrassed business in this way, or wrecking it, as usually happened under a state assignment law, is very great. The advantage offered should be more generally recognized.

A case in a western city emphasizes the possible advantage of this method of settlement. A jobbing house in meeting the shrinkage of the readjustment conditions in 1920 encountered unavoidable financial embarrassment and took the situation up with its creditors. A committee of creditors was appointed to investigate the matter fully and recommend a plan of action. An examination of the books of the concern showed that it could undoubtedly pay out if given an extension on its accounts due the larger creditors, and the committee recommended in its report that the cash on hand be used to pay off the creditors

having small claims, while those having larger accounts should be paid in instalments.

This plan was accepted seemingly by all creditors and checks had been written for all the small items, when a firm of attorneys, having been able to secure claims from three creditors aggregating $500, filed a petition in bankruptcy, thus upsetting the proposed settlement and wrecking the business. One of these three petitioning creditors had a small claim, and within two days would have received a check for payment in full. As it was he received but a small dividend on his own claim in the bankruptcy administration, while he subjected the other creditors to serious loss and aided in preventing the embarrassed firm from saving its business.

Attorneys following such methods should be the object of business condemnation, but they can be prevented from inflicting such injuries to business only by a refusal of creditors to place claims in their hands.

Adjustment Bureaus

The National Association of Credit Men has organized and is maintaining through its affiliated branches eighty or more adjustment bureaus. In handling matters placed in their hands they consider the interest of creditor and debtor alike if there is no indication of dishonesty on the part of the debtor. They work on the basis of getting the largest dividend possible, at a reduced rate of expense, and of saving the business or putting the debtor on his feet again wherever this can be done. These bureaus are located in the more important trade centers, and the best safeguard against the wrecking of temporarily embarrassed firms by unprincipled attorneys will be found in placing all claims with these adjustment bureaus, thus assuring that creditors will have their accounts

handled to produce the largest dividends at a minimum of cost, while the deserving debtor will be given a chance to save what may be the result of his life work.

These bureaus are managed in an altruistic spirit and for the benefit of all business interests concerned. This is illustrated by one case handled by the Omaha bureau during the adjustment period of 1921. A general store in a Nebraska town, with a merchandise stock on which it stood the usual depreciations, suffered a serious fire loss. Its indebtedness was considerable, and the firm had been forced to ask some extensions, but was regarded as solvent. A settlement was effected with the insurance companies. Some of its creditors began to press for payment in full out of the insurance money and were paid. The Omaha creditors placed their claims with the adjustment bureau, and the bureau manager went personally to see the firm.

After looking over the situation, the manager saw that concerted action was necessary. A relative of the firm held its note for a loan of considerable amount and this note was due. The bureau manager sent out a letter to all creditors, announcing that following the adjustment bureau principle he ceased to represent the Omaha creditors alone and would work for all creditors alike. He urged co-operation of all in an extension of the entire indebtedness to be paid in monthly instalments until completely liquidated. The relative holding the note agreed that if this were done, he would wait for his money until all merchandise indebtedness was paid. All creditors accepted the arrangement, and the business was carried on successfully with all indebtedness paid in a reasonable time.

This was a constructive piece of credit management and makes a desirable contrast with the methods of those

attorneys who stand ready to wreck any business for the sake of resulting fees, regardless of the best interests of their clients.

Composition Settlements

The law also permits composition settlements under direction of the court, after the debtor has been adjudicated a bankrupt. The enforcement of such a settlement rests entirely in the discretion of the judge, and when he is satisfied that the offer of compromise is for the best interest of all concerned, he can approve it, which makes it binding on all the creditors even though they did not all regard it as satisfactory. This proceeding often hastens the adjustment, reduces expenses, and gives better returns to creditors than they would receive if the estate went through the full course of bankruptcy procedure under the law to a final dividend.

Punishing and Preventing Fraud

The law has another feature which is unknown to insolvency proceedings under state laws. This is the punishment of bankrupts who attempt fraud upon creditors. In such cases the bankrupt can be compelled to bring books and papers into court and may be examined under oath by the creditors. If assets are evidently concealed or not accounted for, an order of court for the return of them to the estate will issue, and unless complied with he will be under contempt of court, subject to fine or imprisonment. This feature of the law is most beneficial in preventing fraud and it is frequently invoked in discovering concealed assets.

A recent case in a western jurisdiction illustrates what may be done in such a case. A debtor merchant, having a capital of $3,000 or $4,000, whose indebtedness should

not have been at any time in excess of about $5,000, and whose paying record had been good, discovered that the houses from which he was buying were evincing a liberal policy on the line of credit they extended. He concluded to take advantage of this, and in the space of a few months ran his indebtedness up to over $19,000. He then filed a petition in bankruptcy showing assets of about $4,000. He was brought into court and he, his wife, and certain relatives were subjected to a three days' examination under oath. He had deeded a piece of property worth about $16,000, mortgaged for $10,000, to a relative to repay a supposed loan. The examination revealed a state of facts which would bar his discharge as a bankrupt and possibly leave him subject to indictment. He turned over to the creditors about $5,000 in cash, which he had not scheduled, and agreed that the transfer of the real estate should be set aside. In any case in which assets have disappeared in a similar way, united action of the creditors under the law may secure like results.

Provision for Ancillary Proceedings

Another advantage is the provision for ancillary proceedings which enables creditors to reach and administer assets of the estate consisting of property located in other states. This clause frequently brings into estates property that otherwise would escape administration for the benefit of all creditors.

The Law and Court Decisions

Every credit man should become familiar with this law, and keep a copy at hand for continual reference. A copy of it is found in mercantile agency books. When an account gets into the bankruptcy court an attorney will be necessary as a rule for looking after the claim,

but if the credit man has in mind all the provisions of the law, he can better appreciate what information should go to the attorney out of the credit file, when placing the account. This is especially true of a signed property statement, should there be one. With all small accounts the claim may be filed with the trustee direct, taking care to get his acknowledgment that it has been received and filed.

The courts have been construing the bankruptcy law for about twenty-five years, as disputed points have arisen. These decisions coupled with the original law and the various amendments constitute what may be termed a system of bankruptcy law. There are other amendments being suggested from time to time, some of which could be adopted with advantage.

Administration of Bankrupt Estates

The dual administration of temporary receiver and trustee, which involves increased expense, is objected to. A substitute for this plan is proposed through the appointment of a commissioner of bankruptcy who shall be a salaried officer of the court and who shall take charge of every bankruptcy case coming into the court. He may make the preliminary investigation as to whether the debtor is bankrupt under the law, and if so he performs the duties of receiver or trustee until the case is disposed of. It is also urged that a bankrupt shall pay his own attorneys' fees instead of having them taxed against the estate.

The time may come also when this country may adopt the French method of handling insolvencies, which is through a *Tribunal du Commerce*. There are no lawyers or judges. The Tribunal is composed of merchants and business men who are experienced and expert in various

lines of trade. Their findings have the force of a court of record, and there is great saving in fees and expenses. The administration is expedited and creditors receive larger dividends accordingly.

The movement in favor of arbitration agreements in all contracts at the present time, which permit the adjustment of all contests under such contracts by a committee of business men, as a branch of a municipal court, to give judicial effect to their decisions, is a step in this direction.

The credit department should be posted as to certain provisions of the law which have a bearing in all cases.

Debts Having Priority

The following debts have priority over the general creditors in bankruptcy proceedings:

1. All taxes due the United States, the state, county, district, municipality, or any board having legal right to levy taxes.
2. The necessary costs of preserving the estate subsequent to filing the petition.
3. The filing fees in involuntary proceedings, and the reasonable expenses of recovering transferred and concealed assets.
4. The cost of administration and one reasonable attorney's fee for services actually rendered to the petitioning creditors in involuntary petitions, and to the bankrupt in voluntary cases if the court allows.
5. Wages to employees earned within three months prior to bankruptcy proceedings, not exceeding $300 to each claimant.

Acts of Bankruptcy

Acts which throw a business into bankruptcy are as follows:

1. Having concealed, conveyed, transferred, removed, or permitted to be concealed or removed, any part of his property while insolvent with intent to hinder, delay, or defraud his creditors, or any of them.
2. Having transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over other creditors.
3. Having suffered or permitted, while insolvent, any creditor to obtain a preference through legal proceedings, and not having at least five days before a sale or final disposition of any property affected by such preference, vacated or discharged such proceeding.
4. Having made a general assignment for the benefit of his creditors, or, being insolvent, applied for a trustee or receiver for his property, or if because of insolvency a trustee or receiver has been put in charge of his property by legal authority.
5. Has admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground.

If the debtor can show that he was solvent at the time any of the above acts was committed the proceedings shall be dismissed. Involuntary proceedings in bankruptcy cannot be taken against any municipal, railroad, insurance, or banking corporation, nor against any wage-earner or person engaged chiefly in farming or tilling of the soil.

Debts Not Subject to Bankruptcy Law

The following debts are not released by a discharge in bankruptcy:

1. All taxes as heretofore listed.
2. All liabilities for obtaining property by false pretenses or representations.

3. Liability for wilful or malicious injury to the person or property of another.
4. Alimony due or to become due.
5. Maintenance or support of wife or child.
6. Debts not duly scheduled in time for proof and allowance with name of creditor, unless such creditor had knowledge of the proceedings in bankruptcy.
7. Debts created by the fraud, embezzlement, misappropriation, or defalcation of the debtor while acting as an officer or in any fiduciary capacity.

Acts Preventing Discharge of Bankrupt

The following acts will prevent the discharge of the bankrupt from his debts:

1. If he has committed an offense punishable by imprisonment under this law.
2. If, with intent to conceal his financial condition, he has destroyed, concealed, or failed to keep books of account or records from which such condition might be ascertained.
3. If he has obtained money or property on credit by means of a materially false statement in writing made for the purpose of obtaining such credit.
4. If at any time within four months he has removed, destroyed, concealed, or permitted to be removed, destroyed, or concealed, any of his property with intent to hinder, delay, or defraud his creditors.
5. If he has been granted a discharge in voluntary proceedings within six years.
6. If, in the course of the bankruptcy proceedings, he has refused to obey any lawful order of, or to answer any material question approved by, the court.

Suggested Improvements to Law

There is a strong sentiment in favor of doing away with the giving of power of attorney when the creditor

resides within the district in which bankruptcy proceedings have been brought. The result of this ruling would be to secure more interest on the part of the creditors in their bankruptcy cases. This would insure better administration of the law.

It should be made more difficult for the bankrupt to secure a discharge, which should be granted only when the referee can find affirmatively from the proceedings that there is no evidence or presumption of fraud.

The English law should be followed in one respect, viz., when the record is not satisfactory to the judge he may grant the discharge tentatively and hold it in suspense for two years.

Also the bankrupt should be required to show what has become of assets where there is an evident discrepancy.

A wholesome reform would be secured if a discharge were denied unless the estate paid a dividend of 40 per cent to creditors.

Under the present law all decisions are made by the referee except the approval of composition settlements and granting the discharge of the bankrupt. These must be decided by the judge himself.

While it should always be kept in mind that with the beginning of bankruptcy proceedings excessive waste unavoidably results, the national bankruptcy law should be kept in force. A more serious waste would result under state assignment laws. A national law stabilizes and strengthens credit and conserves business. Every credit man should oppose its repeal.

Canadian Bankruptcy Act

Canada has recently adopted a Dominion Bankruptcy Act (effective in 1920), which supersedes the various

province insolvency laws previously in force. The Dominion Act is taken from the English bankruptcy system, with adaptations to meet the different business customs and conditions prevailing in the Canadian Dominion. After two years of experience it was found necessary to revise this act in order to clarify several of its provisions and make it a workable statute in practice.

This law is superior to the United States statute in that it takes cognizance of the dangers and losses resulting from a merchant trading while insolvent. When he becomes unable to meet his obligations, his creditors may at once take charge of his business under the law and take steps to secure payment on his obligations, thus preventing the dissipation of assets which may occur under the administration of the American law. The experience under the Canadian law as to the necessity for amendments is similar to that of the United States, and as the need for these amendments develops from time to time Congress will no doubt afford the necessary relief. England has had a similar experience and has in recent years passed amendments recommended by a commission that spent considerable time in making an exhaustive examination of the defects in administration developed by experience and by changing commercial conditions.

CHAPTER XIII

BY-PRODUCTS IN CREDIT-GRANTING

Insurance

It will not infrequently happen that the credit department will be in charge of placing the insurance for the firm. This will involve keeping track of the amount of merchandise on hand, reducing or increasing the amount of insurance, and watching expirations.

It also requires a careful study of those changes in physical condition of the risk which might affect the terms of the policy, and of any changes or improvements that might be made to reduce the rate of premium.

There are a great many kinds of insurance covering other things about a business than the fire hazard, such as, floater policies covering goods in transit, parcel post, cyclone or tornado, credit insurance, use and occupancy, burglary, employers' liability, "hold up," elevator, public liability, loss of profits, boiler explosions, leases or rentals, sprinkler leakage, and life insurance on executive officers of the firm. All these questions involve study on the part of whoever handles this part of the business. If the firm uses teams, trucks, and automobiles, the various lines of insurance required for them is a complex question.

Advising Customers on Fire Insurance

The question of fire and burglary insurance carried by customers of the house closely affects credits. If the credit man is reasonably well informed on insurance ques-

tions, he may often be able to give suggestions to customers. In many of the smaller towns where the lack of water supply and a well-equipped fire department makes the risk extra hazardous, a high premium rate is charged by the insurance companies and the merchant is tempted to economize on expenses by allowing the creditors to carry a part or all of his fire risk. He thinks he is carrying it himself, but in case of a total loss his first thought usually is to appeal to his creditors for a settlement at 25 cents on the dollar. To help him get a lower rate and show him that no matter what the cost, his credit depends on adequate insurance and the cost of it is an expense item to be included in the price at which he sells his goods, is a part of constructive credit-granting.

In many parts of the country, tornado insurance is desirable and should be carried. Burglary insurance is almost equally essential in many lines of business.

Watching Amounts at Risk

In a period of fluctuating prices a merchant may fail to think of the additional insurance necessary and the credit man may have to call his attention to it. During the period of high costs of material and labor resulting from the World War, many merchants who owned their own buildings suffered serious losses because of inadequate insurance. Many associations of credit men issued warnings to their customers which led to proper increases in the insurance carried. Those who suffered losses in many cases realized for the first time how the 80 per cent coinsurance clause worked out in practice.

Eighty Per Cent Coinsurance Clause

The principle of all insurance is mutual whether the companies work under that name, or whether they are

known as "old line or "board companies. All premiums collected go into a fund from which the companies pay losses. They are the agents for the policy-holders in distributing this fund to those who suffer fire losses. They charge a certain percentage for their services in collecting this fund and making the distribution to those who suffer loss.

In fixing rates the companies say frankly they can and do make a lower rate to those policy-holders who carry insurance to nearly full value of the property at risk, and the 80 per cent coinsurance clause in the policies is based on this theory. The companies illustrate the working of this form of policy by the following tables:

(1)

Value of Property	Insurance	Fire Loss	Company Pays
$10,000	$8,000	$6,000	$6,000
10,000	8,000	8,000	8,000
10,000	8,000	9,000	8,000

In such cases the 80 per cent clause has no effect, as it was complied with and the company paid the entire loss up to the amount of the policy. In the third item the assured stood the loss of $1,000 in excess of his policy.

(2)

Value of Property	Insurance	Fire Loss	Company Pays
$10,000	$6,000	$8,000	$6,000

In this case also the 80 per cent clause has no effect. The loss was 80 per cent, but the assured by carrying less than that amount was his own insurer to the extent of a $2,000 loss, and the company paid the policy in full.

(3)

Value of Property	Insurance	Fire Loss	
$10,000	$7,000	$5,000	
		Company Pays 7/8, or	$4,375
		Assured Pays 1/8, or	625
			$5,000

In this case, where both insurance and loss fall below 80 per cent of the value, the clause comes into operation, and the assured stands his ratio as outlined in the clause. The majority of those carrying insurance have to go through such an adjustment fully to understand the policy.

In case of fire loss an adjustment is more readily reached if all insurance is concurrent—that is, if all policies bear the same form of "rider."

Fire Losses Too Great in This Country

Every credit department should act in harmony with the Fire Prevention Association in an educational campaign to prevent fires. Some years ago the annual fire loss of this country was figured at $3.15 per capita, which in round numbers is over $300,000,000. This became a tax on the commerce of the nation.

For the same year the fire loss of Germany figured 33 cents per capita. The difference results from the German municipal regulations to prevent fires. In addition to better laws for regulating building methods, it is provided that if a German property-owner has a fire on his premises which communicates to and destroys the property of a neighbor, that neighbor has a valid cause of action against him and can collect by a court proceeding the amount of loss he has sustained.

Credit Insurance

Credit insurance has been written in this country for perhaps thirty-five years. One company writes it exclusively. Two or three others furnish such a policy as a department of their business.

To speak accurately, credit insurance is an insurance against excessive losses from bad debts in any one year.

The policy stipulates that the insured must bear the average or known loss before the insurance company is "reached" or is liable. The known loss is ascertained by taking the total losses from bad debts for the preceding five years, dividing by five, and the quotient is the known loss. The insurance is based on the view that a loss is unavoidable each year in that line of trade, and the protection is against excess losses only. The policy also stipulates that it covers only credit risks that have a certain rating in one of the commercial agency books. The insured elects which agency shall be taken for this purpose. The insurance does not cover blank or off-rated risks. These can be covered only by a special contract and at a special premium rate.

The insurance company before issuing a policy or fixing a rate takes into account the standing of the firm in the trade, its policy in granting credits, the effectiveness of its credit department, and other conditions affecting the conduct of the business. When a policy is issued, if at the end of the year there is a liability on the part of the insurance company, the loss of that year is used in determining the rate of average or known loss if the policy is renewed. The form of the rider of the policy will vary considerably in adapting it to the conditions of various lines of business.

Arguments in Favor of Credit Insurance

The main arguments used by those who solicit this class of insurance, are:

1. That by insuring against excessive losses a jobber or manufacturer may know in advance just what his loss will be for the coming year. This is supposing that the policy covers all classes of risks sold, whether rated or not.

2. That it is just as logical and consistent to carry this insurance against bad debt losses as it is to insure against loss by fire.
3. That when the risk of excessive loss by bad debts is insured against, the house can take larger chances in passing credits, and thus do a larger volume of business. This will make for larger profits.
4. That in case of widespread depression, which might result in a panic, the carrying of insurance policies against excessive losses will avoid these losses by throwing them onto an insurance company, and the danger of a panic is averted.

Restrictions in Policies

There are various restrictions in these policies, limiting the amount of loss assumed on any individual risk, providing that the account on which a loss is paid shall be turned over to the insurance company as salvage, and limitations concerning off-rated accounts which enter into the settlement in case the losses of the assured go beyond the limit fixed. The operation of these clauses is better understood in each case after an adjustment is had. The cost of the insurance premium on such a policy should not be lost sight of.

Objections

Those who do not favor this class of insurance object that it is not always possible to anticipate the amount of bad debts in any one year, even when a policy of insurance is carried, and especially if the policy does not cover unrated or off-rated customers. They also believe that it is a bad policy to grant credits relying on an insurance policy to make them good if they develop into a loss; and that it militates against safe methods in credit-granting if the credit man must refer to the policy each time he

passes on an order from an off-rated or blank-rated customer, or if he is being induced to take an undue risk because his house carries this form of insurance.

The comparison with fire insurance does not carry much weight with a credit man. A fire may wipe out every dollar in property that a man possesses, and in the space of an hour or so. That is a risk too great to be carried alone. It is not conceivable, however, that any jobber or manufacturer can lose all his accounts in any one year, as bad debts. If he loses ½ of 1 per cent of them it is usually in excess of normal, and would be as much as an insurance company would give a policy to cover. As to averting or preventing panics, it is plain that if there were a very large volume of this class of insurance outstanding, and a widespread depression of business occurred, the underwriting capital of the companies issuing such policies would be almost immediately used up.

The above considerations no doubt explain why so few companies are engaged in this line of insurance, and also why so few houses, compared with the total number in business, carry this form of insurance. The general sentiment seems to be that the best kind of insurance against excess losses, is a capable credit man who can forecast the conditions which might produce business depression, and whose constant aim is to raise the standard of credit, thereby reducing bad debt losses to a minimum.

Bulk Sales Law

A bulk sales law is now in force in all the states. When it was first enacted in Minnesota it was regarded as probably unconstitutional, being seemingly an interference with the right to contract, and was considered open to objection as class legislation. The supreme court

of the state upheld it, however, as being properly within the police powers of the state, and it was rapidly adopted in other states. It puts a check upon the operations of the "fly-by-nights," who prey upon business by obtaining credit, closing out the merchandise for cash, and disappearing.

The bulk sales law is not a means of collecting debts in itself. It secures a notice for the creditor of any intended sale of a stock of chattels in bulk or outside of the usual course of business. This notice varies somewhat in different states, but the creditor having such notice has time to act in protection of his interest. If the buyer and seller are honest in the transaction and all debts are paid, the law has no bearing on the sale. A failure to give the required notice, makes the stock of goods subject to the claims of creditors according to the wording of the law of the state in which the sale occurs, and the burden of proof is placed upon the buyer and seller to show that the transaction is free from fraudulent intent.

The properly equipped credit department should have a summary of this law for all the states. The procedure in other states would seem to be: Wire claim to an attorney on receipt of the notice, with instructions to investigate the proposed sale and report whether rights of creditors are safeguarded; otherwise take action as he may suggest. A pamphlet has been published by the National Association giving excellent suggestions as to the operation of various bulk sales laws. Every credit student should obtain a copy of this publication.

Conditional Sales Contracts

The conditional sales contract, taken from the Law Merchant, permits the buyer to take possession of the goods but reserves the title in the seller until the purchase

price is paid in cash. The states generally have recognized the validity of this method of sale. Certain states have enacted statutes requiring such contracts to be filed or recorded to protect the right of the seller. It is generally recognized that the buyer can pass title to innocent purchasers, since he has the right to do this under the contract. In such case the seller has a claim on the proceeds of the sale where it can be identified, as in the case of a note.

In cases of insolvency the seller used to be able to apply to court for an order requiring the assignee to turn back to him any merchandise on hand which had been bought under such a contract. The theory was that the assignee stepped into the place of the original buyer and took his rights under such contract.

This construction of the contract was followed by the courts under the national bankruptcy law until the amendment of 1910, which provided that the trustee took the place of the creditors with all the rights of a judgment creditor in possession. This nullified the conditional sales contract after bankruptcy proceedings, but the courts still hold it good as between seller and buyer prior to bankruptcy. The seller can at any time repossess himself of the merchandise or chattels on hand under the contract either by agreement with the buyer or by order of court. This form of contract is used to advantage by many houses and could be so used by many others.

Uniform Sales Laws

A uniform sales law is being quite rapidly adopted by the states. It, in fact, embodies the Law Merchant so far as it is adaptable, and includes "Statutes of Frauds." It should be studied by credit departments, as it will become the basis of laws governing sales when all

the states have adopted it. A copy of this law should be in every credit department for reference.

The Negotiable Instruments Law

The negotiable instruments law is now in force in every state, with possibly one exception. It results in uniformity on this subject, and it should be at hand for reference in every credit office. It is printed in at least one of the commercial agency books.

Foreign Corporation Laws

Just before and immediately after the Civil War the corporation form of doing business received a great impetus. As they increased in numbers and began to do business throughout the country, the question of the right of these corporations to do business in other states, and especially to use the court processes of other states in collecting debts from the citizens of that state, began to be raised. States began to legislate against foreign corporations in a very drastic way, denying them the privilege of the court processes unless they filed copies of their charter in such state and in other ways made themselves subject to the taxing powers of the foreign states in which they sought to do business.

Wherever such legislation has been reviewed by the United States Supreme Court such enactments have been held unconstitutional as violating the clause of the Constitution giving Congress the power to regulate commerce between the states. It is difficult for the individual state to interfere with interstate commerce. These foreign corporation laws still stand, however, and the credit department must deal with them. Many manufacturing corporations which maintain selling branches in other states have credits passed upon and all orders accepted at

the home office, which makes the business safely interstate commerce. It is a proposition requiring the study of the credit department.

Relative Advantage of Branches

The character of the business, the terms and conditions under which sales are made, will usually be strong determining factors. If orders are taken in advance for goods to be manufactured according to specifications and shipped in one consignment from factory or mill when completed, thus supplying the requirements of the buyer in great part for the season, it will be more advantageous to pass the credit and accept the order at the home office. But if such branch houses are established as distributing points for staple goods in that territory, many advantages will result from passing the credits at the branches.

Carrying a stock of goods at branches which come in carload lots from the factory effects a great saving in carrying charges, and the promptness with which small orders can be filled will be such a convenience to the customers of the house that a substantial increase in volume of business usually results. The credit man at the branch house will be better informed as to local conditions affecting credits, can maintain a closer acquaintance, can come in touch with a larger number of the customers, and can handle collections more successfully. These advantages of a branch house so conducted have led many firms to incorporate these branches, notably in the state of Texas, thereby obtaining the advantages of a domestic corporation and avoiding the drastic requirements of foreign corporation laws.

The detail connected with many of these questions will be referred to the attorney of the firm as they come up for decision, because of varying facts and conditions.

CHAPTER XIV

BANKING CREDITS

A Knowledge of Bank Credits Beneficial

A student of mercantile credits should have a general knowledge of the principles and methods which apply in managing the credit department of a bank. A knowledge of banking details and practice is an aid in the conduct of a mercantile credit department. Some authorities hold that such information is essential.

It may be also that a student of mercantile credits will desire to enter the credit department of a bank. In such a case a preliminary study of banking credits will prove to be of value in taking up that line of work.

Old Banking System

A great change has been wrought in banking methods since the adoption of the federal reserve system. Much that had been written concerning bank credits prior to that time is greatly modified or does not apply. Not only banking methods but many details of commercial business have been changed in the process of adjustment to the new conditions brought about by the federal reserve law.

A brief review of the old banking system will lead to a clearer comprehension of these changes. Prior to 1912 the nation had approximately 7,200 national banks and 15,000 state banks. The national banks were supervised by the Comptroller of the Currency, and the state banks by the banking department of each state. Private banks had no supervision.

Currency was issued either by the government against gold and silver in the United States Treasury, or by the national banks against government bonds owned by them. This system of currency issue had no flexibility in that the issue could not be increased on short notice when business needs demanded it.

The national banks in the three central reserve cities of New York, Chicago, and St. Louis were required to maintain a reserve of 25 per cent of their deposits in cash in their own vaults. Those in the reserve cities were compelled to carry an equal reserve, but one-half of it or less could be in the form of deposits in one of the central reserve cities. The third class of national banks, referred to as country banks, had 15 per cent of their deposits for their minimum reserve requirements, two-fifths or more of which had to be cash in their own vaults, and three-fifths or less could be carried as deposits in a central reserve or reserve city.

The Crop Moving Problem

The year was divided into two periods. The first six months was the time of moderate demand for loans, when normally the interest rate was at the lowest point. The last six months was the crop-moving period, when the banks were obliged to reduce their loans to commercial borrowers and give back in currency to the interior banks the deposits held from them, and to some extent loan them additional funds for moving to market the cotton and grain crops. By January of the following year the greater part of the crop-moving currency had found its way back into the banks again.

If during this crop-moving period anything occurred to shake public confidence, people began to hoard currency and withdraw it from the bank deposits at a time

when the supply was usually only sufficient for actual needs. When this happened, conditions leading to a panic were immediately created. A wild scramble between banks was precipitated, each trying to get and hold enough currency to maintain the legal cash reserve, which under the banking law was essential to solvency.

The banks in the reserve cities would practically suspend currency payments and would issue clearing-house loan certificates in settlement of balances due each other. Employers of labor, not being able to secure currency from their banks, would pay their employees with checks. All such expedients would only add to the scare. Foreign countries would share in the alarm and begin to sell back American securities held abroad and demand gold in exchange. When the foreign creditors were assured that this country was solvent and that there was no cause for distrust, they replied that it was difficult to maintain faith in a currency system which had no elasticity to meet the crop-moving demand, or in a credit system which broke down whenever it was brought under this strain. They therefore preferred to take no chances.

These business-destroying conditions would prevail until confidence could be gradually restored. All this time the banks had their vaults well filled with commercial paper, the very best form of credit security, but it was not possible to realize on it. Business was temporarily paralyzed and credit largely suspended, while the liquidation of credits outstanding was impeded and losses greatly increased.

The Federal Reserve System

It was an unbearable condition, but no concerted effort to provide an adequate remedy was made until the unexpected panic of 1907 roused the commercial forces of the

country to determined action. The Aldrich Monetary Commission was appointed and after thorough investigation and study it submitted a report outlining the organization of a new banking system. On the basis of this report Congress finally enacted the Federal Reserve law, which has proved to be a splendid piece of constructive work, embodying such an improved banking system as the business interests of the country were demanding.

Before the passage of the law, however, it was found that the bankers themselves were not fully agreed as to its merits. Those who had advocated the branch banking system were not entirely satisfied. There were others who were in doubt as to the danger of undue inflation of the currency which might result. There was also some doubt as to how the new plan might stand the strain of expansion and governmental financing in the event of a war. It has been said by high authority that the most potent influence in bringing about the enactment of the law was the insistent demand of the National Association of Credit Men and other commercial bodies which insisted that the work of the commission should not go into the scrap-heap, that its plan was workable, and that the time had come to give the nation the relief which this law would afford. As one leading banker expressed it: "Without the support of the man on the street, it might not have been possible to secure the enactment of the law." At the present time it seems evident that the bankers are now almost unanimous in favoring the law, and they describe the federal reserve banks as "reservoirs of credit."

The test of the law in the event of war came with unexpected suddenness and almost before the system had been brought into working order. There may always be a question among students of economic and financial his-

tory as to whether there would have been a war had the former banking system of the United States been still in operation when the World War began. Would it have been possible to finance the needs of the nations engaged in it, and at the same time meet the requirements of this nation? If not, then the war would have been of short duration and doubtful outcome. Was there an element of Providence which brought the system into action just in time?

Benefits of System

The Federal Reserve Act furnishes a plan for mobilizing the entire banking capital of the country on short notice. The united financial strength of the country can be concentrated at any weak point in time to relieve any stringency. The system is cohesive, co-operative, and co-ordinated. Its relation to the Treasury Department of the government is ideal for governmental financing, and at the outset stood successfully the greatest test in this direction which it will ever be likely to meet. It went through an unparalleled period of currency inflation without a jar, and with its present entire freedom from political entanglement or control it commands the confidence of the people to an extent that furnishes an almost absolute safeguard against panics.

The student of banking practice should become familiar with the law in its entirety, but one or two of its requirements may be here mentioned:

1. No federal reserve bank can be organized without at least $4,000,000 capital.

2. Member banks are required to carry with their federal reserve bank as a reserve 7 per cent of their demand deposits and 3 per cent of their time deposits. Reserve city banks are required to carry 10 per cent of their de-

mand deposits and 3 per cent of time deposits. Central reserve city banks are required to carry 13 per cent of demand deposits and 3 per cent of time deposits.

3. Deposits subject to call within thirty days are classed as demand deposits, and those running for more than thirty days count as time deposits.

Plan First Suggested by a Credit Man

The nucleus of the federal reserve system as adopted, was first suggested by a credit man, D. S. Ludlum, of the Philadelphia National Bank of Philadelphia, in an article published in 1908. He based his plan on the relief offered during the panic of 1907, by clearing house loan certificates, and proposed to divide the country into ten or twelve clearing house districts. Every bank was to become a member of the clearing house for its district. In case of a currency panic each bank was to have the privilege of depositing commercial paper with the district clearing house as security on which it would receive clearing house loan certificates, and these certificates were to be used as currency. They were to be surrendered as soon as normal conditions returned. In the plan finally adopted district reserve banks were substituted for district clearing houses, and currency (federal reserve notes) was issued instead of clearing house certificates, the commercial paper being used as rediscounts, or for collateral, according to circumstances.

Relation of Banks to Credit

It was always held to be a cardinal principle that banks are the keystone in the arch of mercantile credit. The successful operation of the federal banking system demonstrated the truth of this claim. Banks have been called the custodians of credit. When banking credits

are sound and reliable, the rate of interest is stabilized, confidence is maintained, all business progresses at a normal volume, collections are to be depended upon, and commerce is developed on a safe basis.

With this brief view of the banking system as it is now functioning the student may more readily grasp the underlying principles of bank credits. One of the primary facts to be considered is that banks are mainly loaning the money of their depositors. They therefore must count on receiving payment of their loans at maturity. If, when loans are due, the depositors show no indications of needing their money and the outlook is good for an easy money period, a bank may be willing to renew a loan, but it is not under obligations to do so.

Experience has shown banks, especially in the larger cities, that it is not advisable to loan more than 60 per cent of their deposits. This keeps in hand a working margin above the legal reserve as a safeguard against an unexpected stringency. The banking laws are very drastic and every careful banker plans to keep safely away from any possibility of suspending payment.

Judging Bank Credits

The student of banking credits will find there is not so much difference in the manner of passing on bank loans as compared with mercantile credits. In both lines capital, capacity, and character are the basic principles. The banker adds the fourth C for collateral, and he draws a finer distinction between repuation and character.

The banker also depends more upon the signed financial statement. This is because he is in a position to require it. Unless the applicant is well and favorably known, he usually cannot obtain the loan without furnishing such a statement.

When the statement is received the banker can take the time necessary for analyzing and verifying it, and if it seems advisable, he can send an auditor from the bank to check the statement with the books of the applicant. This conservative method of treating statements no doubt is the result of experience, which has crystallized into an aphorism: "A man tells his hopes to his banker; he tells his fears to his lawyer."

In analyzing a statement the first thought is the amount of strictly liquid assets, consisting of cash, accounts and notes receivable, and merchandise and material, for these assets must be looked to for repayment of the loan. As a matter of conservatism and with the shrinkage in mind which always goes with possible liquidation, the liquid assets will be scaled 10 per cent on receivables and merchandise. Unless after this treatment the quick assets are still double the liabilities, in most lines of business the proposed loan will call for closer investigation.

Basis for Bank Loans

The kind of business in which the applicant is engaged will be considered. A staple line well advertised in the market, and in steady demand will carry less risk than special articles for which a sale must be created and on which a steady volume of trade is not yet assured.

The question will also arise as to how the customer proposes to use the money if the loan is granted. Is it for pay-rolls and for taking cash discounts on purchases? These are legitimate objects, as money so used is a supplement to working capital. If the loan is to be used for additions to factory and equipment, or for expanding the business, it will not be a desirable loan

for a bank. Such needs should be supplied by additional capital. If the whole situation does not up to this point, make the loan seem desirable, the bank will inquire as to the standing of the principals. If they represent some financial responsibility personally, the loan may be granted on their guaranty, given as an evidence of good faith and as additional security.

Credit Department of Bank

While the loan is under consideration the credit department will be making up a very complete credit file, investigating the character and experience of those interested, the manner in which trade obligations have been met, and the popularity of the product or the line of goods handled. The business standing and judgment of the principals will be carefully considered. The average cash balance which the firm has carried for a year or more will be tabulated. No strict rule will be enforced as to the amount of cash balance which is required as a basis for loans, but a firm desiring a bank line of credit for $50,000 is ordinarily expected to carry an average cash balance or deposit of $10,000. It is good practice and good business judgment with all borrowing firms to carry a liberal bank balance. This strengthens the credit of the firm with its bank and eases up the mental strain for the executive who looks after the financing of the firm's business.

The investigation by a bank credit department will be much more searching and thorough, and will deal more definitely with personality and ability than in the work of the mercantile credits. In this respect the French method is being adopted. Into the credit file of a French banker (*le dossier*) goes every scrap or fragment of information concerning the personal habits, the

social connections, the relatives, newspaper clippings, and other details, which seemingly are unnecessary. An American writer on this subject has recently indicated that our bankers are now following a similar system, and even extending their records to cover the characteristics developed by the sons of their customers, who some day may come into control of the business.

Analyzing the Bank Credit File

The customer seeking a bank loan will be expected to pay the same at maturity, and the credit department will seek definite information on this point. It will also endeavor to learn whether there is a reasonable expectation that he can do so. Every bank loan should be paid up within the year, and good banking practice requires that such loans should be paid out in from six to eight months. This is necessary in order that the assets of the bank may be kept properly liquid.

The investigation will also ascertain whether the applicant has a borrowing account at other banks. If so, is a proportionate cash balance carried on deposit with the other banks, and will they continue the line of banking credit they are extending, or are they planning to restrict or discontinue it? If granting the loan asked is to be merely a part of a plan for changing banks, it may not be considered further.

Another point will be considered: Is this customer selling his own paper through note-brokers, and to what extent? This is a method of expanding his credit, and notes placed in that way must be paid at maturity even though the maker is obliged to ask a renewal at his bank. There is no obligation to renew on the part of the broker. This factor will have a very definite effect on the decision.

The applicant will also be asked whether he is dis-

counting his bills receivable and to what extent, as this creates contingent liability under his indorsement of such paper, and is using up that part of his assets in advance of maturity, for obtaining working capital.

With regular customers the credit department of a bank compiles a comparative analysis of the financial statements of those who are borrowing customers. This shows from year to year the fluctuations in assets and liabilities, and the increase or decrease of working capital. This comparison is a barometer test of the business, and if healthy growth is not maintained, or the firm seems to be going backward by this showing, the matter is taken up with the borrower for an explanation.

In banking practice the credit department does not pass on loans. It is in a way the statistical or information department obtaining the facts on which the authorized executives decide as to lines of credit to be extended. In smaller banks the executive who fixes the line of banking credit to be given may also supervise the work of securing credit information and keeping credit files revised.

Fixed Assets in Property Statement

In analyzing the property statements of manufacturing firms the banker will usually find the item of fixed assets consisting of real estate, buildings, and equipment. This item is not considered in determining the loan, as at that time only liquid assets are sought for, and the banker does not expect to rely upon the manufacturing plant for the payment of the loan. This asset has a bearing, however, on the situation as a whole. Is it clear of encumbrance? If so, a long-term loan might be obtained on it in case some unexpected condition developed.

How much of the firm's capital is invested in this asset? If all or nearly all has been absorbed in this way,

the investment is out of proportion and the firm must borrow all or nearly all its working capital. This is not favorable for a banking loan. The fixed asset investment should only be large enough adequately to care for the volume of business undertaken and leave a safe proportion for conducting that business.

Banker Advising Customer

Bankers always desire to sustain close confidential relations with their customers and to know what changes are being considered, if any, in their policies or conduct of the business. Very frequently they can give good advice. An experienced banker in discussing this phase of banking, says: "Use your banker in every way possible, especially for suggestions. He will appreciate it and you will be greatly benefited."

It has been said that bankers are often the best merchants. Every business man is experienced and well posted in his own line, but the banker in making loans in a community or market must be well informed concerning every line to which he extends banking credit.

Purchase of Commercial Paper

Nearly every bank, in large as well as small towns, buys commercial paper at certain seasons of the year. In so doing they are investing on short maturities any surplus funds not in immediate demand by regular customers. This keeps idle funds in temporary use, and in buying such paper from note-brokers the bank selects the maturity dates which will bring the money back at the time when it will be required for regular demand. Such paper is usually bought on ten days' approval, and it is the work of the credit department to make up a credit file on each piece of paper handled. This investigation is made very

searching, as the bank does not need to, and will not, take any chances whatever on this form of investment.

Modern banks usually have a bond and stock account in which their own funds may be invested. This form of credit as well as the handling of foreign bills of exchange comes under the management of executives who are experienced and expert in these departments.

Skill Required in Banking Credits

An experienced banker has briefly summarized banking credit in this way:

> There are no fixed rules or infallible tests as to the granting of credits. It is, of course, essential that the borrower shall have a good business reputation, that he give evidence of his capacity to conduct his business efficiently, and that he have sufficient resources of his own, so that his borrowings may be only for his current needs. The use of bank credit is merely a means by which borrowers and lenders are brought together, the bank being the intermediary.

The granting of bank credits requires the very highest order of ability and financial judgment. The vast sums of depositors' money loaned through the banks in the course of a year must be handled with little or no loss. The banker, in extending these loans, must forecast the future not only as to the probable trend of the money market and general business conditions, but also as to the influences and probabilities affecting the particular business of the firm requiring the loan. He must guard against unexpected contingencies so far as possible. This requires sagacity, experience, keenness of power to analyze, and an almost unerring judgment as to causes that are becoming operative and their probable effect during the year to come. Forecasting the future intelligently and accurately is a banker's most important problem.

CHAPTER XV

RETAIL AND INSTALMENT CREDITS

Concerns Extending the Credits

This field of credit-granting covers a wide range of business. There are two general classes of houses extending these two kinds of credit: (1) department stores and those which sell entirely on the instalment plan, the large retail houses in the larger cities coming under the classification of department stores; (2) general merchandise stores and concerns doing a retail business.

The department stores and those selling on instalments have as a rule organized credit departments. In the smaller retail houses credits are passed upon by the proprietor. The student of credits will be more directly interested in retail credits as handled by a credit department.

Credit Manager Also a Salesman

The same principles which govern in wholesale credits will apply in retail merchandising in a general way, but the information on which the credit is based is obtained from other sources, and the details and methods will involve a very different policy and manner of handling.

In a retail house the credit department will give more attention to increasing sales, and will work in more direct co-operation with the sales department. The increase of sales will result chiefly from increasing the number of customers having charge accounts.

If the volume of sales can be doubled in a retail business without increasing the losses, the profit of the house will be greatly increased. A psychological influence is invoked through increasing the volume of credit business. A customer who buys only for cash will be a shopper, going from place to place and finally buying where the best bargain seems to offer. The customer with an account will be very apt to go to the store or stores where the purchases will be charged. It has also been demonstrated that the charge customers will buy more liberally than if currency is being paid out on each purchase.

There is a saving of time with the charge account. As soon as the sale is recorded the customer goes on to visit the next department. There is no waiting for change. If it is desired to have the goods purchased sent for inspection and approval at home, this can be done without the inconvenience of depositing the purchase price in cash. The charge account offers various inducements for increasing the volume of purchases.

Encouraging Charge Accounts

There are three ways in which such accounts are obtained. In the first, the sales and credit departments working together are constantly preparing lists of people who may be desirable charge customers, and when a name goes on the list the credit standing of the person is investigated. If found satisfactory an invitation is extended to open a credit account with the house and this is followed up until the arrangement is made, or until it seems evident that the account is not desired.

The second method of obtaining charge accounts is where customers apply for such accounts. This also gives the credit department opportunity for investigation in advance. If the applicant is engaged in business it is

comparatively easy to learn his personal standing. If not, references are obtained from him, and his previous paying record ascertained. The specific facts desired for the credit file will be the place of residence, the position he holds, amount of salary or income, and the character and extent of his property resources, name of his bank and the average balance carried. Also does he have charge accounts with other houses?

Methods of Obtaining Information

A good credit authority commenting on the manner of obtaining retail credit information, says: "It is somewhat surprising to learn that some of the strongest and most influential houses in the larger cities will seek data on credits from janitors of flat buildings and apartments, from butchers and from small trades people generally."

When such facts as the above are to be obtained from a woman customer in a personal interview, the credit manager should assume a pleasant, matter-of-course manner, implying that these are customary questions asked of everybody and while they are being answered he is alert and studying the applicant as well as the answers carefully for any contradiction, discrepancy, or other unfavorable symptom. Such an interview is dreaded by the average woman who looks upon it as an unpleasant or unnecessary ordeal. If the matter is handled diplomatically, she may be made to feel that her standing is well and favorably known, that the questions are merely a matter of form, and that the house is pleased at having secured her patronage. The interview closes, leaving her somewhat flattered and relieved at the outcome. Such a customer will be more easily held, as her goodwill is secured at the start.

In the third method of getting charge accounts a cus-

tomer enters the store, makes a purchase, and for the first time says: "Charge it." The checking clerk, not finding the name on the credit account list (copy of which by card system is in every department), the purchaser is at once taken to the credit manager's desk.

Such cases will prove to be the most difficult for him. In a very brief interview, without embarrassing the customer, he must secure enough facts on which to decide the credit pending and enough information if possible on which to make up a credit file before the next purchase is made. He tries to make the customer feel that the house is pleased to have the opportunity to secure the account, and on investigation the account may prove to be very desirable. This first purchase therefore may be passed on very meager information rather than take the change of offending an excellent prospective customer.

There will be cases where a customer does not have a record justifying the credit, but who can be induced to give a good indorser or other security.

Qualifications of Retail Credit Man

A high authority on credits expresses the opinion that "passing on personal or individual retail credits is the most onerous of credit tasks."

The retail credit manager therefore must train himself to be an expert judge of human nature, to read character quickly and accurately, and must develop the faculty of keeping in mind the personal characteristics and preferences of every customer. Accounts must be watched very closely. If an account runs over the end of the month the manager must supply in his mind the reason why. At the time the account was opened the time of payment was fixed as the 10th day of the following month. This customer may be in Europe, Florida, or California for a

vacation, and it will be paid in due time. Or the account may need immediate attention. He must know in which class it belongs.

Collection of Accounts

Retail accounts must be watched more closely than in wholesale credits. Unless the customer is of unquestioned standing, a limit is fixed on every account. This limit may be changed or raised more than once in any month, but the change cannot be made without the notice and consent of the credit manager. In the collecting of such accounts, good judgment and discretion are required. In some houses a second statement is mailed on the fifteenth of each month for all unpaid accounts unless they are known to be gilt-edged. The ledger will show whether statements are to be mailed to the business address or to the residence of the customer. Many customers have a decided preference on this point which must be respected.

If accounts go beyond the 15th of the month following with no explanation and no known reason for non-payment, then either a courteous letter is written suggesting payment, or it may be given to a discreet collector for an interview. Neither of these plans is followed without careful consideration because customers are naturally sensitive and resent anything taking the form of a "dun," whether by mail or in person.

Suing a retail account is a last resort, as no house is willing to take any chance on being considered as exacting or hasty in collecting its accounts or suing its patrons.

The retail credit manager comes into personal contact with a larger proportion of the customers than is possible in wholesale credits, and he has therefore greater responsibility in keeping customers satisfied. He can do this more successfully if he is in charge of the cashier, the

accounting and employing departments, shipping, and complaints. Avoiding dissatisfaction is a sure method of increasing sales.

Credit Losses of Small Retail Stores

The student of credits will find a separate and distinct problem in considering the small retail stores, all of which have charge accounts in considerable volume, but have no credit departments. Such credits are moral risks to a great extent. They are given to a very large number of people. It is difficult to classify them; very few cases are alike. The losses resulting from such credits fall heavily on the small merchants, who are least able to bear them. If they give way under the burden, the loss is passed on to the jobbers or manufacturers who gave them credit.

In summing up the losses to the nation from bad debts, statisticians take the figures of the rated wholesale and manufacturing firms which fail and leave their creditors to share their losses. They stop there. What would be the aggregate if to that great total should be added the bad debts sustained by the small retail merchants who stand this loss themselves, and get through without failure. Would this loss, if it could be definitely ascertained, double the figures compiled by the mercantile agencies? It can only be a matter of speculation, but as a matter of economics, in so far as this loss is an indirect tax on business and is shifted to the consumers who do meet their obligations, it is a part of the equation of retail credits.

Lack of Ability and Courage

This loss results in great part from the fact that retail merchants are not intelligent in granting credits. This is because they have no facilities for training in this depart-

ment of their business, nor for obtaining information concerning the customers asking credit.

A lack of business courage may be the underlying fault. They fear that they may lose trade if they ask perfectly legitimate questions of the customer concerning information they are entitled to have before extending credit. They refrain from asking, grant the credit, and regret afterwards.

They are afraid their competitor down the street will get the business. The desire to increase volume—do more business—blinds their judgment and they take a chance.

The solution of the difficulty is to educate the retail merchant and get him to substitute co-operation for competition. This is being accomplished by the organization of business men's associations in the smaller towns, with bureaus for interchange of ledger information on customers. This plan of organization should be made more general. The retail merchant must be educated also to see that he should extend credit only to those who are surely able to meet their obligations promptly. Unless they do so, how will he be able to meet his own payments?

Instalment Credits—A Growing Business

In the field of instalment credits the problems of credit-granting are much the same as to the principles involved and the methods of obtaining information, as in retail credits. The differences to be noted are mainly these: The customers are secured chiefly through advertising, and therefore every purchaser who enters the store has cost the firm a certain outlay, figured in the advertising account. Unless he is sold, the firm probably does not get another chance at him. The credit department therefore is an auxiliary to the sales department to a greater degree than in retail credits.

It was once considered that a customer bought on the instalment plan because he could not obtain credit elsewhere or on any other basis. As this plan of merchandising has come to occupy a larger field, that view no longer obtains. A customer may have a good-sized deposit in a savings bank against which he does not wish to draw until after the next interest period. Or he may be a man with a good salary or other income, but for special reasons wishes to distribute the outlay over a certain time. Also the payment down of part cash is a distinctive feature which may vary according to circumstances.

Character of Patrons

Three classes of customers will be found in those who apply for credit:

1. Those who are entirely responsible. This class presents no difficulty in passing the credit.
2. Those who are of good intentions, but who in making the selection of the merchandise offered are tempted to buy more expensive goods or in larger amount than their circumstances will justify. Their desires get the better of their judgment. Intelligent co-operation of sales and credit departments becomes necessary in such cases.
3. Those who buy without intending to pay. This class fortunately is relatively small, but always a danger, always more difficult to handle and frequently not so easily detected. Sometimes they are easily discovered because they are amateurs and betray themselves unconsciously through awkwardness. But if they are experienced professionals, the fact may not be discovered till too late. They are an incidental risk of the business. In any suspicious case the policy of making the cash down part of payment as large as possible may help to decide.

The man who passes upon instalment credits must be a reader of men and a judge of human nature, for his decisions must be made on short notice, in many cases without opportunity to make detailed investigation. He must be quick in analysis of the information obtained in the first interview, and he must avail himself of the judgment which the salesman may have formed in going through the details of making the sale. The sales and credit departments in this line must both collaborate and co-operate.

In this class of credits the credit manager has one resource not often used in other lines of credit, viz., a lien on the goods sold. Yet it is a remedy of which he does not ever wish to avail himself, except as a last resort. He wishes to avoid always the necessity of taking back the goods, for in nearly every case this means a loss through depreciation.

Importance of Good Collections

The collection system in instalment credits becomes possibly the most important feature. A doubtful credit may sometime be passed and the collector of the territory instructed to keep close watch of it.

A collector calls for every instalment the day it is due and is insistent as to payment. Only a very legitimate reason for non-payment will secure a consideration, and only the credit manager or head of the collection department decides as to whether any extension may be granted. Prompt collections have the same or greater importance in this line of business. They provide the funds for the conduct of the business; they may increase sales, for even a good customer, if behind on payments and needing additional merchandise, would probably go to another house for it; while any one payment in default

may throw all the later instalments behind. If instalments once begin to lap overdue, there is great danger at once of a default which can only be adjusted by foreclosure. The daily reports of collectors and wise decisions concerning all overdue instalments therefore are very important.

CHAPTER XVI

FOREIGN CREDITS

Selling and Credit Allied

This branch of mercantile credits will have a constantly increasing importance to the student as the United States continues to develop its export trade. The great growth of population will make it necessary for this nation to find a foreign market for its manufactured products in order to keep labor employed. The problem of securing foreign trade while paying a higher rate of wage than prevails in any other country is more properly a question of economics.

Without export trade, however, there is little incentive to the study of foreign credit conditions. The two are so closely connected in matters of detail that the study of one involves the other. The subject is here presented in a general way, giving only suggestions as to what is involved in foreign credit-granting. The concrete study of the proposition will vary according to the country or countries in which sales are made, the character of the goods sold, and the terms which the exporting house is willing to grant

Cash With Order and Long-Term Credits

In the past the greater part of the foreign shipments from the United States has been paid for before the goods left the country. On this class of shipments no real question of credit arises. The foreign buyer de-

posits funds in a bank in this country at the port of shipment subject to the draft of the seller when accompanied by proper bill of lading and other documents. Such sales are practically for cash with order. The American manufacturer has enjoyed such a volume of domestic demand that he has not really sought for foreign trade in a large volume and in competition with other countries. The foreign buyer will purchase here on the cash basis only while or when he is unable to obtain the goods elsewhere. When the United States begins to go after export trade in earnest, then the longer terms will have to be granted, and foreign credits will receive the same careful treatment and investigation as is now given to domestic mercantile credits.

For a great many years manufacturers in certain lines have been obtaining foreign business on long-term credits. They either sent representatives abroad who secured the business by making satisfactory terms of payment, or representatives of foreign houses came to this country and concluded arrangements in a way to satisfy credit requirements.

The United States has awakened to the fact that foreign trade in volume can be secured only by giving satisfactory credit terms and the facilities for doing so have been provided for in different forms of legislation.

Improved Facilities under Federal Reserve Act

The provision in the Federal Reserve Act permitting national banks to accept drafts on behalf of their customers and the foreign buyers, thus creating the bankers' bill of exchange, was the first step towards establishing an exchange market in this country as an aid to financing foreign trade.

The act also provides that any national banking as-

sociation having a capital and surplus of $1,000,000 or more may, with the approval of the Federal Reserve Board, establish branch banks in foreign countries and in dependencies of the United States. Prior to that arrangement the financing of our export trade was done mostly by English banking houses in pounds sterling.

In 1916 the Federal Reserve Act was amended to permit national banks to co-operate in the ownership of American banks or corporations principally engaged in foreign banking, by investing not to exceed 10 per cent of their capital and surplus in such enterprises. Banks of this class have been organized to finance the export trade of the country.

Other Helpful Legislation

In September, 1919, a law known as the "McLean Bill" became effective. It permits national banks to invest 5 per cent of their capital and surplus in corporations formed to aid in financing foreign trade.

On December 24, 1919, a law designated as the "Edge Act" went into effect. Its purpose is to finance export trade on long-time credits through a federal incorporation of banking institutions to engage in foreign banking. In a dependency of the United States the incorporation may have the ownership or control of the local banking institutions established. Banks under this law may not become members of the federal reserve system, and are not allowed to invest more than 10 per cent of their resources in any other than a banking corporation. They may not receive deposits in the United States except for the purpose of export trade transactions.

This act contemplates two classes of corporations: one class does principally a foreign trade banking business; the other class does an investment business, taking long-

term paper, including bonds and mortgages, which are acceptable in form and security to the Federal Reserve Board, and issuing their own short-term debenture notes against these securities. These debenture notes are sold in the investment market and out of the proceeds the American exporter is paid.

In this way the private capital of American investors promotes and finances export trade. Under the above laws there have been organized the American Foreign Banking Corporation of New York, the First Federal Foreign Banking Association of New York, the First National Corporation of Boston, the Asia Banking Corporation of New York, and others.

Attention to Details

The details of foreign credits will seem complicated to the student at the beginning. It will involve special study for each country, and will be mastered through experience. Certain general principles resulting from experience are these:

No foreign order should be shipped on time credit to any country without favorable and absolutely authentic information. A positive order that comes unsolicited for immediate shipment is always open to suspicion and must be carefully investigated. All C. O. D. shipments are unsafe because of the distance and the heavy carrying charges in case the shipment is not accepted by the buyer. This does not mean that all foreign buyers are unreliable, but that there are in every country those who are dishonest and ready to take advantage. Only the most vigilant care will prevent this class from carrying out their schemes, as they have little fear of punishment and the difficulties of forcing collections are too great.

Terms and prices must always be so positively and

clearly agreed upon that there shall be no chance for a misunderstanding. In quoting F. O. B. New York, the quotation should be free on board cars New York, and give the buyer no chance to imagine that it means free on board vessel in New York harbor.

There are two other abbreviations in common use. F. A. S., or free along side vessel, means that the seller pays freights from point of shipment to seaboard, the freight handlers, and lighterage charges. The buyer pays cost of loading from lighter to hold of vessel.

The quotation C. I. F. means cost, insurance, and freight, and carries the understanding that the seller pays for putting the merchandise aboard the vessel, takes out the insurance policy, arranges the freight rates, secures the bill of lading, and either pays all these charges at time of shipment or agrees that the buyer may deduct these items in remitting. It should be stipulated that this quotation does not include any foreign import duties, cost of consular invoices, or any other items. In quoting C. I. F. prices it should be plainly stated that the marine insurance policy shall read "Free of particular average." Should the particular average clause be covered by the policy the premium rate will be much higher.

Foreign Credit Information—Agency Reports

In securing credit information the commercial agency rating books of foreign countries will not be found very reliable. In fact only a few are available. They are said to be not sufficiently comprehensive. There are too many omissions. This form of credit service is not so fully developed and not nearly so efficient abroad as in this country.

The best foreign reports come through the leading American mercantile agencies. It takes some time in

many cases to obtain a comprehensive reliable report and the cost may be considerable at times, but these are no doubt always worth the fee that is charged. R. G. Dun and Company has about 70 foreign branches, and the number is constantly increasing. Where they do not have branches they secure information through foreign mercantile agencies or correspondents.

One of these agencies gave considerable attention to establishing a branch in the Empire of India to report all merchants on the American plan. The undertaking encountered great difficulties. In India merchants frequently change their names. In some cases the change is made because of taking up some different line of merchandise. Or if the merchant removes to another town or village he makes a change in name that he thinks will give him some trade or advertising advantage in his new location. In some of the cities of India the names and numbering of the streets present difficulties. The streets are all narrow and the names somewhat indefinite. Some of the buildings will bear the old number and some a new number in case any change in the method of numbering has occurred. Such an undertaking in the face of these obstacles is a credit to American enterprise.

Reports from Banks Reliable

Foreign credit reports from banks are customary and are generally reliable. A better report and prompter reply is usually secured when the American exporter gets his own bank to make the inquiry, as the foreign bank will give more confidential details of information when writing another bank. If the seller inquires through one of the larger New York banks doing a foreign exchange business, it may be found that this bank already has in its files up-to-date information on the firm inquired about.

It is not worth while to ask an American consul for credit information. The consular service regulations of the State Department do not permit him to furnish it.

Property Statement and Interchange of Information

It is not good form to ask a foreign buyer for a signed financial statement. They are not accustomed to doing this and they have yet to be educated to this method of establishing credit. In Latin-American countries as well as in the Orient such a request would be regarded as akin to an insult. If a foreign buyer should submit with an order a property statement unsolicited it would be a cause for suspicion and a case for very careful investigation.

Interchange of trade information with American houses doing export business will bring desirable results. One of these is the American Export Company of New York. The foreign credit department of the National Association of Credit Men, the Philadelphia Commercial Museum, the National Association of Manufacturers, and similar organizations have accumulated large numbers of files. When the foreign buyer gives references, mention should always be made of the fact that they are so given when information is asked for.

Important Features in Foreign Trade

In all European countries except Great Britain the keeping of books of account is required by law. The United States may some day follow this wise precedent.

It is desirable to know the commercial laws and customs of the countries in which the American seller does business, so far as possible. If he has a trade-mark, it should be recorded in each country. Otherwise some enterprising merchant of that country may record it for him. In that case he pays royalty to the foreign recorder

for the privilege of selling his goods there under his own trade-mark.

Accepted time drafts are often held by foreign bankers until goods have arrived and are inspected, and banks will sometimes store goods in a warehouse until the buyer can arrange for funds with which to pay the draft. The foreign banks of some countries will take more chances in helping out their customers in this way than is considered safe practice from the American standpoint. During the World War period when gold was at a premium in South American countries, the buyer would frequently ask the bank holding draft to wait until the premium on gold went down. This is not good banking practice, but an exigency likely to arise in foreign credits.

Proper Form of Correspondence

Even when foreign time credits are extended only to houses that are supposed to be entirely solvent, collection problems will arise at the maturity of such accounts. The correspondence about such items should be the embodiment of diplomatic courtesy and always polite in the extreme. The customer may be waiting for more favorable exchange rates before remitting. He considers it entirely legitimate to do this. The seller therefore waits a reasonable time after maturity before beginning to suggest payment. The remittance may be in the mail and delayed in transit, or it may be lost. When it may become evident that payment is being unduly delayed, the seller begins his campaign for getting the money. It will be proper to make a plea that the prices at which the goods were sold were very low and were quoted only because the high financial standing of the buyer was a guaranty of prompt payment at maturity.

Or it may be mentioned that the seller is a manufac-

turer, not a banker; therefore he must count on prompt payment at maturity in order to meet his own obligations. Also it may be in order to propose charging interest from the day the account matured. The foreign bank should in all cases have instructions to protest drafts not accepted or not paid within the legal time limit.

Litigation on a Foreign Account

Legal action on a foreign account should always be avoided, and resorted to only when the size of the account and other circumstances make it seem imperative. In such a case the claim should be forwarded by an American attorney who will attend to verifying the claim in proper form with the necessary official certificates as to the authority of the notary who administered the oath. He can also make better selection of the attorney in the foreign country who is to handle the claim.

When an American creditor puts himself under the jurisdiction of the courts of a foreign land, he must be prepared for anything that may happen. He may be called upon at once to give a bond that will protect the debtor from any damage that may result to him from the suit. The creditor may be lucky if he is not in the end held for the full amount of the bond. On small claims the general experience indicates that it is wiser to call them a loss from the start and save trouble.

A prominent American banker discussing this subject says: "Litigation is to be avoided in South American countries above everything else, for the expense and trouble more than outweigh the value of the claim."

In this discussion of foreign credits only the rudiments of the subject can be given. The student who wishes to pursue the study will find several volumes of several hundred pages each which have been published,

giving in much detail the conditions which prevail and the methods of handling drafts for different countries. The development of the foreign trade of the country will make credits a study of great interest also because of constantly changing conditions.

Credit as a Factor in the Foreign Field

It will be found, as foreign trade develops, that credit is even a greater factor in this field than in domestic business. Since the establishment of the federal reserve banking system and the enactment of the supplementary laws in aid of financing foreign trade transactions, the American exporter has been placed in position to meet the competition of other countries in financing foreign business without taxing his resources to a greater extent than in his home trade. He is not yet fully informed as to these facilities which are at his command in handling foreign trade. With the discount market now being developed in this country for handling foreign bills of exchange the American manufacturer can give credit and yet practically sell for cash through discounting facilities. basis for financing foreign trade. Exporters will find it much

Practical Advice

A New York bank through its foreign exchange department makes these suggestions to its customers:

A reasonable term of credit, generally speaking, allows thirty days after the arrival of the goods. There are few places in the world where merchandise cannot be delivered, under ordinary conditions, within sixty days from the American port of shipment. Therefore, ninety days is usually considered ample.

In foreign, as well as in domestic business, the most advantageous method for the buyer is to purchase on open account. This much sought after and elastic form of credit, however, involves tying up the seller's capital, and is not a satisfactory basis for financing foreign trade. Exporters will find it much more satisfactory to draw against their customers at sight, or at

a certain number of days after sight, or at so many days after date of invoice. The drafts may be "clean" (without documents attached), or duplicate or original shipping documents may be attached, the title to the goods then passing either upon satisfactory acceptance of the draft or upon its payment. The draft may be for the face of the invoice, or with collection and interest charges added, according to the terms of the sale. The interest charge includes not only the term of the draft, but also the time that is likely to be consumed in getting back the proceeds when it is paid. A sixty days' sight draft, for example, drawn on some place which the mails require thirty days to reach, would call for 120 days' interest: sixty days from the acceptance date, and thirty days each for the transit of the draft from and to the point of origin. If the draft is on some country where the rates of exchange are subject to more or less fluctuation, it is customary to include in the draft this clause: "Payable at the collecting bank's selling rate for demand drafts on———" (New York or London, according to whether the draft is in dollars or sterling). This clause prevents the buyer from fixing his own rate, which would be to his advantage.

To convert the draft into cash as soon as he gets the bill of lading, the exporter takes it to his bank for discount. This he will have little or no difficulty in doing if it is drawn at sight and the documents are attached, providing, also, that everything else is in order and that the merchandise is of a kind that will be readily salable if the buyer should not pay on delivery.

If the draft is payable a certain number of days after acceptance, the credit standing of the acceptor becomes an important factor in seeking to discount the paper. In such a case, the goods pass into the buyer's hands before he pays. Therefore, lacking the added security of title to the goods until they are paid for, the bank looks first at the responsibility of the exporter and then upon the credit standing of the importer abroad, if that can be established.

The bank having agreed to discount the bill of exchange, the exporter receives credit for its face, less interest and collection charges. The transaction, therefore, is closed, so far as he is concerned, practically as if he had made the sale of the goods for cash. He has received his money, and the buyer has received the credit agreed on. In certain cases, however, the bank may think best to safeguard itself by advancing the exporter only a portion of the

amount of the draft—25 or 50 per cent, or more—or it may not take the draft at all, except for collection, and then may make its advance on receiving word that the draft has been accepted. In these matters, the credit standing of the firms or individuals involved exert exactly the same influences as they do in the financing of domestic shipments.

It will be seen that the foreign buyer must pay the greater part of all the collection and interest charges. It may be that, feeling that he can do this better at his end of the line, he will prefer to arrange what is called an "acceptance credit." To do this, he obtains a letter of credit from his local bank. This is directed to an American bank and authorizes it to accept drafts drawn by one or more American exporters on certain terms of credit, the shipping documents being attached to the bills of exchange. In this case, the transaction is between the two banks. The American bank accepts the drafts and documents and sends them to the foreign bank, which provides the funds to cover the transactions, and looks to its own customer for reimbursement. The accepting bank, while it discounts the drafts for its own customers, is protected by the foreign bank's guaranty.

Bank Acceptance

The bank acceptance is beyond doubt the most satisfactory method of financing export shipments, and it can be usually arranged for without difficulty. The American exporter, instead of refusing foreign trade unless he receives cash with the order, can quote his price on the basis that his customer open a credit in New York through a bank that is acquainted with this foreign buyer's financial responsibility. Two banking commissions may have to be paid, but the lower rate of discount commanded by a prime acceptance, that is, a bank acceptance, provides practically a spot cash price for the goods, which will more than offset the commissions.

A more general study of our present system for handling this class of foreign credits will show manufacturers the possibilities of these facilities, and encourage them to compete for a larger volume of foreign trade.

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